# HOWARD A. BAKER

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# CREDIT AND ITS USES

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BY

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# PREFACE

The people who take a deep interest in credit are divided into two classes: first, those to whom it appeals as an interesting and necessary study in the field of economic phenomena; and second, those who are actively engaged in dispensing it, as a vital complement of commercial usage and requirement.

The purpose of this work is to demonstrate the all-powerful influence of credit in the ministration of the world's affairs; to explain the principles involved in the question, and to show how its practical application to mercantile life depends so completely on a correct knowledge and observance of those principles. The writer appreciates the delicate and important nature of the task he has attempted to perform, and offers this contribution to what has already been said on the subject with a realization of its deficiencies.

During the last ten years credit men of banks and business concerns have exhibited much interest in the study of credit; but in the furtherance of the very commendable effort made by many of them to encourage investigations in it there has always been a disposition to dismiss the academic features of the subject in favor of what are termed its practical elements. The author has sought to give to both the academic and practical sides their full measure of attention, and to accord to each its due prominence. If he has succeeded in doing so he will feel that his labors have not been without favorable result.

In the preparation of Parts III and IV, and also Chapter XIX of the book, which are concerned with the administration of credits and the question of credit insurance, the writer has asked the views of active and practical credit men in every section of the country—this in justice to those who will do him the honor of reading the book, and especially to those who desire to familiarize themselves with the duties of credit work. Although the writer has been a credit man, he considers that in offering a book of this character to the public it would not be proper to confine himself solely to his own experiences or opinions; but, in the interests of a broad discussion of credit distribution and management, he should add to them, wherever necessary, a statement of the methods of others, in order that no ideas worthy of recording might be overlooked. In every instance, however, where conclusions are drawn they are the author's own.

The writer takes this formal and public means of expressing to all those who have so considerately helped him by their counsel his very heartfelt sense of obligation. The number of those who belong in this category is too large to permit the mention of the individual names, a condition which the writer regrets. A specially cordial word of thanks, however, is due to Mr. James G. Cannon, Vice President of the Fourth National Bank of New York, for the opportunity afforded the writer to use the facilities of the credit department of that institution in preparing the material for the chapter on "The Credit Department in Banking Credit," and also the forms incorporated in that chapter.

NEW YORK, 1906. **W. A. P.**

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# PART ONE

# CREDIT, ITS FUNCTION AND ORGANIZATION

# CHAPTER I

## THE THEORY OF CREDIT

The number of those who are affected either directly or indirectly by the dispensation of credit represents a very large proportion of the inhabitants of the civilized world. In view of the constantly expanding area and influence of commerce and commercial customs which subsist mainly upon the operations of the great organism of credit, it could almost be claimed that in these days, at least, all sections of the world, civilized and uncivilized, are susceptible to the subtle and lasting control which credit diffuses.

It is the general acceptation that money and credit constitute one of the elements or branches of political economy; for this reason no utterance on credit would be adequate that did not include at least a reference to this great theme. Political economy, or the science of economics, is variously defined; but the differences refer more to form of expression than divergence of actual conception or interpretation. The meaning of the term has, however, undergone considerable change in the course of the ages, as is shown by the fact that in its earliest use it was known among the Greeks as "the art of prudent and systematic household management." The changes wrought by the new institutions that rose upon the wrecks

of the Grecian and Roman systems of local and state rule broadened the scope of political economy until it was regarded as embracing the more important and extensive management of state and national affairs, or "the art of directing the incomes, the industry, the consumption, and expenditures of the State and its subjects with frugality and care."

Political economy was formerly considered a department or function of statesmanship; and the definition just quoted will readily suggest why this was so, as the task of directing the incomes, the industry, the consumption, and expenditures of the state and its subjects should be the great and precious care of those who direct the destinies of nations. As one authority says, in the nineteenth century, political economy was divorced from statesmanship and came to be looked upon as a "neutral science." It is also true that since this separation the science of political economy has made tremendous strides, not only in the wealth of new material brought forth by its followers, but in the influence their teachings have exercised upon the multitude. In referring to this change as having taken place in the last century, we are not unmindful that the first great clarion note which announced the coming of this change was in the form of Adam Smith's masterpiece, "The Wealth of Nations," which appeared in the last quarter of the eighteenth century. We are indebted to Messrs. J. B. Say and John Stuart Mill (types of a distinguished school of writers) for their services in defining the tenets of latter-day political economy. Their terse descriptions of the study as the "Production, Consumption, and Distribution of Wealth" and the "Production, Distribution, and Exchange of Wealth," respec-

tively, have become familiar terms in the discussion of social, economic, and political questions. There can be no question that the lucidity with which they have put forth their views has contributed greatly to a better comprehension of the theories involved in the rights, opportunities, and wants of mankind; and this notice, however brief and imperfect, is a necessary adjunct of any writing on credit. The relation of credit to these quantities must not be overlooked or disregarded, especially by those who are its guardians and dispensers. Before leaving this branch of the subject, it should be said that the light that has been thrown upon the economic issues of the past hundred years from the study of the phenomena which constitutes political economy, has certainly served to make a better, a happier, a more contented people. It has enabled them to better understand their wants and provide for them, to better appreciate their rights and defend them, to discern their opportunities and take advantage of them; so that we can add what has been so well said by others on this point, that political economy is the "ordered knowledge of the social phenomena arising out of man's activity in the acquisition and use of wealth."

In considering credit as a science, we are met by many conflicting and contradictory ideas and statements. A number of writers have regarded credit merely as one of the elements entering into the larger sphere of economics, and not as a separate and distinct entity. It has, in fact, been a favorite remark of many lay writers, especially business men engaged in credit work, "that credit can hardly be called an exact science"; but rarely has there been any substantial effort made to prove this statement either by reference to the authorities or by personal argu-

ment. Science is "any department of knowledge in which the results of investigation have been worked out and systematized, an exact and systematic statement of knowledge concerning some subject or group of subjects." Are we prepared to say that the principles of credit have been worked out and systematized to such an extent and with such precision that we are warranted in claiming that credit has been reduced to a science? Mr. Macleod has taken a more advanced position on this question than any other writer, and as is usual with him makes his assertions with extreme positiveness. He claims that he has worked out the bearings and principles of credit from the earliest uses to the present time, and brought the subject to scientific demonstration. He admits that this demonstration is the outcome of the world's experience during 2,238 years. In other words, from the time of the Romans to his own day the process has involved the study and exposition of its methods and practices, the judicial interpretations of the question in all its forms, and the reduction of the different quantities known as credits or debts to algebraic demonstration.

The origin of credit dates back many years, and attempts have been made to mark it with the honor of extreme antiquity. Mr. Aldrich, in his "Money and Credit," treats entertainingly of the customs supposed to be prevalent in Babylon and Phœnicia, from which it is shown that "credit instruments" were to all intents and purposes in use in those ancient lands. There can be no question, however, that credit was used by the Romans, and Mr. Macleod has given a very clear picture of their ideas and practices, which he confidently claims form the basis of the origin of credit. Another strong argument

in support of this position is the fact that the fundamental bases of the laws affecting credit of even this day can be traced, as he says, to the legislation of Justinian. These laws show indubitably that the Romans practiced credit in its most modern utilities, and instituted the custom of using credits as the basis of providing themselves with capital when needed. It is a remarkable thing that the system of credit originated by the Romans, and which differs in no essentials—if at all—from the purposes and functions of credit which we employ to-day, should have practically disappeared until a few centuries ago, barring the banking credit of some of the Italian cities and that of the Bank of Amsterdam in the Middle Ages. This may also be looked upon as another reason why the theory or principles of credit have not been more thoroughly understood and appreciated, but it is certain that the theory of the question must have for its foundation some known position, customs, and laws, for it is claimed that "concrete practice always precedes abstract theory."

The elementary principles of credit may be comprehended thus: that credit is the natural sequence of man's desires to avail himself of the use of certain species of property; and for the repayment of this property in its original or equivalent form, he utilizes certain elements of both tangible and intangible character to induce the owner to part with his property to him. The tangible element is represented by the property of him who is seeking credit and which he pledges either by actual transfer or lien, or by the good faith that is reposed in him, that he will preserve that property either in its original or equivalent form so that it will serve as a practical basis of his ability to redeem the obligation incurred. Where

the question of good faith enters, there the intangible takes a place as one of the elementary principles of credit; also this question of good faith may be the only basis upon which credit is sought or extended, and at times is, to a great extent, the only basis recognized in mercantile credit. Good faith covers character and its elements, respectability, honesty, uprightness, the manner in which a man's abilities will be exercised, whether industriously or sluggishly, and we shall later see credit is, to a very large extent, dependent upon these intangible elements. When we consider, as Professor Ely has said, that "the characteristic instrument of exchange in our day is not money but credit, and its development measures the perfection of modern exchange," we can understand the pervading influence of this branch of economics.

The author does not desire to expound or exploit any favorite ideas or theories simply for the sake of pride of originality, but, on the contrary, to express only those views which have a justification in practice and in the principles and statements of the authorities, as will be shown by the following accepted definitions on the question of credit.

1. A general view.

"Credit is the confidence that is reposed in the ability and purpose of men to meet future obligations."

2. Mr. Henry Thornton: "An Inquiry into the Nature and Effects of the Paper Credit of Great Britain."

"Commercial credit may be defined to be that confidence which subsists among commercial men in respect to their mercantile affairs. This confidence operates in many ways: it disposes them to lend money to each other, to bring themselves under various

pecuniary engagements by the acceptance and indorsement of bills, and also to sell and deliver goods in consideration of an equivalent promised to be given at a subsequent period."

3. Mr. Henry C. Carey: "The Credit System in France, Great Britain, and the United States."

"Credit cannot exist without confidence in the security of property and in the disposition of the purchaser of a commodity to pay for it at the time appointed. No man parts with his property except when he believes that an equivalent will be returned."

4. Mr. Walter Bagehot: "Lombard Street."

(a) "Credit—the disposition of one man to trust another—is singularly varying."

(b) "Credit is an opinion generated by circumstances and varying with those circumstances. The state of credit at any particular time is a matter of fact only to be ascertained like other matters of fact; it can only be known by trial and inquiry."

5. Mr. Henry Dunning Macleod, M. A.: "The Theory of Credit."

"Credit is the present right to a future payment or credit is, therefore, the right or property of demanding something from some one else. It is the right to a *future payment*; it is the name of a certain species of right or property. Gold and silver money may be called metallic credit."

6. Mrs. Millicent Garrett Fawcett: "Political Economy for Beginners."

"Credit is a power to borrow. If the credit of an individual is good, it is because there is general confidence in his ability to pay, and therefore he can borrow at a low rate of interest. If the credit of an individual is bad, he is not able to borrow except at a high rate of interest, because his ability to pay is doubted. The credit of different people in the same age and country can be accurately measured by the rate of interest which they pay for borrowing."

7. Prof. J. Lawrence Laughlin: "Credit."

"Credit is machinery invented to aid in accomplishing the purposes of capital; if an essential function of capital is to discount the future, the essential characteristic of credit is the element in it of futurity. The connection is not far to seek."

"To get credit, therefore, is to obtain a transfer to oneself of commodities under an obligation (variously expressed, according to different habits and circumstances) to return an equivalent amount at a fixed date in the future."

8. Prof. Richard T. Ely: "Outlines of Economics."

(*a*) "A word of many meanings."

(*b*) "Credit is a transfer of goods for a promised equivalent."

9. Mr. Wilbur Aldrich: "Money and Credit."

"Credit may . . . be defined to be an economic quantity arising out of a business as a going concern, and proportional in amount to the reputation of the business, its property, and the rapidity and regularity of its cash turnover. The use of credit does not tie up or hamper the free use of the material capital belonging to the concern using its credit. Only business men have credit in a commercial sense, and it is not the moral character of a person which gives him credit, but his business reputation. A corporation may have this business reputation. To have credit a business man or concern must be known to be regular in paying debts, and the business must be a paying one, giving reasonable expectation of continued ability to meet obligations promptly."

10. Prof. Frederick A. Cleveland: "Funds and Their Uses."

"These two judgments lie at the basis of all credit; on these two elements does the value of credit rest. (1) A judgment that the one promising is able to fulfill his promise. (2) A judgment that he will be *willing*. Willingness is another name for 'honesty' or 'integrity.' Confidence is nothing more or less than the result

of judgment that a person is both *able* and *willing* to do what he promises."

11. Mr. Frederick B. Goddard: "Giving and Getting Credit."

"Commercial credit is the name of that trust which is reposed in men because of their character and resources. In other words, it is an estimate of ability and disposition to fulfill business engagements, which confers purchasing power; power to command the industry or capital of others."

12. Prof. C. J. Bullock: "Introduction to the Study of Economics."

"Credit may be defined as the power to secure commodities or services at the present time in return for some equivalent promised at a future time."

The foregoing estimates of credit have not been selected with a view to proving any one or chosen concept of the subject; they may be reasonably and reliably accepted as a fair and average expression of competent authorities on the meaning and range of the question. From them we can assuredly draw accurate conclusions as to the influences affecting credit, as well as a definite judgment of its theory or principles. An analysis of the definitions submitted reveals this result: that the principles involved in credit are:

A. That it rests largely on confidence, trust, faith, and good opinion.

B. That it is not moral character (*per se*), but business reputation that establishes and maintains good credit.

C. That it is a power inherently resting upon the qualities enumerated (in A) to borrow money or any other class of property.

D. That one of the principal elements entering into credit is that of futurity, or a deferred fulfillment of an obligation.

Professor Laughlin in his treatise on "Credit" discounts the theory or general opinion, we might say, that credit is largely dependent on confidence; and holds that confidence only enters into the case as it relates to the element of futurity. It is not my desire to break a lance with the gifted Laughlin, but I do take issue with the attempts to make it appear that the element of confidence is a subordinate one; and that, especially in mercantile credit, the theory of "goods to goods" has a controlling place. A system where credit is based upon collateral properties may be superficially more advantageous than one where the element of risk is predominant, but it is with the present world we are dealing; it is with man as we know him and as he is that we are doing business, and that business must be regulated as we find him. The part that confidence plays in credit has always been a subject of controversy, due to the fact that most writers on the subject of economics being unfamiliar with *mercantile life and customs*, fail to distinguish between the systems of banking credit and mercantile credit; and give most of their attention to the functions of instruments of credit.

No matter how earnest may be the effort or persuasive the argument, it is simply impossible to dismiss "confidence" as the leading requisite of credit. It is noticeable that even where staid economists treat the question solely as one of "value based on collateral value," we find many authorities who can be quoted to the contrary; for example, Mill says:

"As the confidence on which credit is grounded extends itself, means are developed by which even the smallest portion of capital, the sums which each person keeps by him to meet contingencies, are made available for productive uses."

Mr. Walter Bagehot says:

"Credit means that a certain confidence is given, and a certain trust reposed. Is that trust justified? and is that confidence wise? These are the cardinal questions. To put it more simply—credit is a set of promises to pay; will those promises be kept? Especially in banking, where the 'liabilities,' or promises to pay, are so large, and the time at which to pay them, if exacted, is so short, an instant capacity to meet engagements is the cardinal excellence."

It will be observed that Mr. Mill speaks of the *confidence on which credit is grounded.* Could anything be clearer than this in setting forth confidence as "the primary element in credit"? But further, and quite as conclusive, Mr. Bagehot says in referring to confidence and trust as elements of credit, "These are the cardinal questions." But probably the most striking statement as to the place that confidence fills and should fill in credit comes from Mr. Mill, whom we have just quoted. In speaking on the benefits of credit, he says:

"This benefit will be reaped far more largely, whenever, through better laws and better education, the community shall have made such *progress in integrity* that *personal character* can be accepted as a sufficient guarantee not only against dishonestly appropriating, but against dishonestly risking what belongs to another."

Mr. Macleod in considering credit never relinquishes his theory as to the legal environment of credit and his definition is, therefore, of more than ordinary interest, differing as it does so radically in phraseology and content from almost all other definitions, whether of the English, French, or German schools. He says, "Credit is a present right to a future payment," and there could be no

better expression. A merchant sells a bill of goods; he parts with possession of the property, and it, as well as the title to it, passes to the person to whom the sale has been made. What does the merchant hold as against the sale? Simply the "right" to collect the equivalent of the sale at the appointed time of payment or settlement. He cannot retake the goods forcibly except under certain conditions which are not germane to this phase of the discussion; he cannot compel the customer to give him back the goods; all he holds is the right to expect and exact payment when the latter is due. He can dispose of that right (as Mr. Macleod says) and raise funds upon it. If that right exists only in the form of a book account, he can dispose of it just the same as if it were an instrument of credit (a check, note, draft, etc.) by selling to another or transferring to another the "right" to exact payment in his place. The case differs in no way if the merchant at the time the sale is made accepts a note for the amount of the invoice—the note is nothing more than the "right" (expressed in words) to a certain sum of money at a certain time; and this note or "right" can be sold, or discounted, or used as borrowing material. Mr. Macleod's own words on this question are worthy of full notice, as follows:

"Every case of a 'Loan' of Money or a Sale of goods 'on Credit' is an exchange; or an act of commerce. In exchange for the Money or the Goods a Right of action is created; and is the price of the goods. This Right of action is a Saleable Commodity; which may be bought and sold like any material chattel: and it has value because it will be paid in money. This Right of action may circulate in commerce exactly like a piece of money, and effect exchanges exactly like a piece of money, until it is paid off and extinguished: and then it ceases to exist."

The endeavor has been to provide an exposition of the "theory of credit" which would accord in all essential respects to the best thought obtainable, and especially such a description of the nature of the study as would be easily applicable to the ordinary usages of trade and industry, and therefore well within the ready grasp of business men, to whom a thorough knowledge and dialectic appreciation of the principles of credit is highly essential.

## CHAPTER II

### THE CREDIT SYSTEM

Mr. Stephen Colwell, in his work on "Ways and Means of Payment," calls attention to the difference between "credit" and the "credit system." The principle of credit, viewed as an abstract proposition, must not be confounded with the great system by means of which transactions in credit are conducted, and the tremendous volume of debts and credits brought into being, passed from hand to hand in the routine of business, and finally liquidated.

Mr. Macleod has given us an almost classical interpretation of the credit system, which, he says "comprehends: 1, the creation of obligations; 2, the transfer of credits or debts; 3, the extinction of obligations."

In these three processes we see the origin, the existence, and the wiping out of a business transaction based on credit. Much may happen during the life of a credit to alter its value; the general character of a credit or debt depends very largely on the nature of the conditions or forces that bring it into life; what is commenced well usually prospers, and a good account will be rendered when the end has arrived. It will be apparent that the character of credit transactions is predicated on the tone or morale of the system itself, for all credit systems are

not good, and all have their weaknesses as well as their virtues. "The main point on which one system of credit differs from another is soundness."

As the requirements of commerce, due to the discovery of new lands and increase of population (and the general tendencies of modern civilization) have become more and more exacting, the system of credit has been subjected to a tremendous development; but from a scientific viewpoint this is merely the natural evolution of economic forces, evident always to the keen observer of the conditions underlying the nature and expansion of commerce.

Those who have investigated the theory and system of credit, whether from the viewpoint of scientific propositions or commercial customs of ancient or modern application, are unanimous in declaring that their fundamental precepts rest upon immutable decrees of use and treatment, which man must observe with unceasing faithfulness if he would obey the dictates of wisdom and prudence. To disregard these laws will inevitably produce distrust and disaster.

A duty of more than ordinary importance rests upon those who regulate and control the system of credit. The terms "regulation" and "control" are somewhat figurative, for the system of credit does not physically submit itself into the hands of any few men or interests. It is probably one of the weaknesses of the system that its good management must depend upon the collective judgments and will of a very great number of men and interests, each acting for himself, almost always on his own individual ideas of right and wrong, of accuracy and inaccuracy, responsible only to himself. No wonder that there should be a demand for a coöperative rather than an indi-

vidual interest. Much has been done toward the question of wise regulation by the watchfulness, as well as by the ministering influences of the clearing houses, especially in times of stress and danger; but the "regulation" and "control" should be constant, active, energetic, and powerful; and the credit system will never have reached that state of soundness which the general judgment of men, even to-day, claims should be attained, until those who have this great trust in their hands take the necessary steps to bring about the results that wisdom and conservatism demand.

A system of credit is in itself a proof that the ideas and customs of the people have reached a state of development associated with advanced civilization. Among backward races and peoples credit is not used; more primitive and simpler methods satisfy the desires of such peoples; Mr. Henry C. Carey says ("The Credit System in France, Great Britain, and the United States"): "The existence of a system of general credit is evidence that the people comprising the community in which it exists believe that their neighbors are honest and will pay the debts they may contract." This is another reminder of the prominence and prevalence of confidence in the structure of credit, and in every branch of the subject we find confidence ever present as a determining factor in the operations of credit.

The credit system must naturally have had its inception in the earliest form in which credit was practiced, this form assuming the character of "personal credit." Therefore, "personal credit resting solely on the good faith of the creditor was the earliest form in which credit appeared." The needs and exactions of commerce devel-

oped this form of credit until it was in general practice, and thus we have the present system of credit. The spanning of the many years during which this system became the force it is to-day was accompanied by many changes in men's methods, manners, and customs, and the present system is the fruition of a long travail of economic evolution. Mr. Bagehot says:

> "Credit is a power which may grow, but cannot be constructed. Those who live under a great and firm system of credit must consider that if they break up that one they will never see another, for it will take years upon years to make a successor to it."

It is therefore necessary to bring the study forward from the sphere of personal credit or "credit in its simplest form," "that of money lent by one person to another and paid directly into his hands," to that stage where it occupies the most prominent place in the movements of commerce. Credit holds this place of prominence not alone by virtue of its organic merit as an economic force, but also from the fact that its utilities have been exercised and adjusted by such means as enable it to satisfy fully the demands of commerce, viz., by the use of instruments of credit.

We now come to an extremely interesting and ramifying function of credit as well as one of its most illuminating principles, and that is the uses of "credit as a substitute for money." These uses take different forms, namely: bills of exchange, accommodation bills, promissory notes, bank notes, and checks. They are all evidences of actual indebtedness, except in their primary state, when given for accommodation, and as such, when accepted in satisfaction of an account or debt of any kind, they are

credits pure and simple. But they do not represent credit given only to the person who originally tendered the note, we will say, in payment of an account to his creditor; but the creditor, in nearly all cases, secures credit for himself upon this same paper by either tendering it in turn in payment of an indebtedness of his own, or by discounting it with a bank or money lender, which interests may renegotiate it for purposes of their own. A note for $1,000 may be used six times over, and in several of these instances employed in the purchase of goods, thus proving the absolute soundness of the argument that credit is a creator of purchasing power.

This brings to the forefront another feature of the functions and effects of credit. Bills of exchange, notes, checks, etc., given from hand to hand, distributed from one district to another, become a part of the circulating medium of the country, and to the extent that these instruments of credit represent real and tangible property, they contribute life and stability to this branch of our circulating medium, and in the ratio that they represent fictitious undertakings and purely speculative enterprise, they make for unsoundness fraught with dangerous complications to that medium.

Mr. Mill holds that credit being only permission to use the capital of another, the means of production cannot be increased by it, but only transferred. This statement has considerable bearing upon the workings of the credit system, as the functions of that system have been held by many to augment the purchasing power of a nation, or to add to the means of production. Means of production refer to those methods through which the productive capacity of the country can be utilized. If from

any cause capital is hoarded, or general impoverishment should exist among a people, they assuredly have not the means and cannot secure the means with which to purchase machinery, tools, and other necessary equipment to either start or maintain manufactures, or mining, or the other numberless forms of industry in which an intelligent people are interested; and also the absence of proper equipment to till the soil and harvest the crops reduces the power and results of production.

As the productive capacity of a people measures its material power and prestige, the credit system should be tested and utilized to its full legitimate strength in order to draw out the best fruits of that capacity. The uses of the credit system put a developing power into the hands of the people with which they further their productive capacity, and credit thus becomes a creator of purchasing power. Mr. Mill enters a qualifying statement as to the purchasing power of credit, or its effects as purchasing power, when he says:

> "Credit, in short, has exactly the same purchasing power with money; and as money tells upon prices not simply in proportion to its amount, but to its amount multiplied by the number of times it changes hands, so also does credit; and credit transferable from hand to hand is in that proportion more potent than credit which only performs one purchase."

It is an economic truism that the credit system draws wealth into the channels of trade and productivity; in fact, this is the primal function of credit. Personal qualities are reckoned as wealth, and the credit system, in providing means for the activity and display of these personal qualities, is performing just as important a duty as when it brings about the introduction of material "pros-

perity" in the uses of trade. Economically, personal qualities are a part of the wealth of every people, although many hold that such qualities should not be included and that wealth refers to "those objects that are external to man."

No enumeration of the advantages of credit sets forth the great merits of the system in more forceful style than that of Professor Conrad of Halle, in his lectures on political economy which are quoted in full by Professor Ely in his article on "German Coöperative Credit Unions." It is a graphic presentation of the origin and utilities of those institutions. The statement which follows comprises the quotation to which reference has been made, with the exception of division No. 9, which is Professor Ely's own:

"(1) Credit furnishes a more perfect and convenient means of payment in large sums and between distant places than the precious metals, saving time and labor. This is effected by means of notes, checks, and bills of exchange. (2) Credit takes the place of corresponding amounts of gold and silver. This is a saving, as it enables us to employ the precious metals for other useful purposes. (3) Capital is employed more productively. He who possesses capital, but is for any reason unable to make use of it, transfers it to another for a compensation, to the benefit of both, as well as that of the public economy. It is given, *cæteris paribus*, to him who is ready to pay the highest price for its use; that is, in general, to him who can employ it most productively. (4) The laborers, artisans, and traders, although unprovided with means of their own, may by the use of credit obtain capital to assist them in their labors, and that without sacrificing their independence. This point is to be particularly borne in mind as of especial weight in judging the credit unions. Credit is thus of importance in avoiding that separation of capital and labor which excites so much bad feeling, and which forebodes danger to modern civilization.

(5) Credit gathers together the smallest sums, which, by means of joint-stock companies and otherwise, are economically employed. Capital is concentrated, but its returns are disseminated among the people, politically a weighty point. (6) The possibility of employing every sum, however minute, urges people on to saving. (7) Credit binds together the interests of those having dealings with one another. Under a highly developed system of credit economy, it is the interest of each to show himself worthy of trust; this can be of advantage in the moral education of a people. (8) It enables men to save for their old age, and make provision for their families in case of their death. Were there no such thing as credit, the best one could do would be to heap up, and then consume afterwards, the capital gathered together. (9) Capital, when obtained under favorable circumstances, yields a larger return than the interest. Were it otherwise, borrowing, except in case of special need and distress, would cease. The prudent and skillful laborer who can command credit is thus enabled to obtain, besides his wages, a surplus from the use of the capital. Credit, *well used*, is therefore economically as productive as a favorable climate or a high education of a people."

A discussion of the foregoing will show how these advantages of credit affect our everyday life and demonstrate the growth and usefulness of the credit system.

(1) It would be impossible to carry on the business of the commercial world to-day unless we had such agencies as notes, checks, and bills of exchange: First, for the reason that the stock of precious metals would not be adequate to the discharge of the daily clearings of commerce; and second, that it would utterly disorganize business procedure if we had to depend upon the transfer of the precious metals in order to effect the extinguishment of obligations. The delays, even with our present excellent transportation facilities, would be the cause of much inconvenience, and the very nature of these commodities

would make their use for this purpose cumbersome and unscientific. Further, the expense involved in moving the precious metals for such purposes would add a considerable percentage to the cost of doing business: the expense entailed would refer not only to the cost of shipping, as far as distance and bulk are concerned, but, more important still, to the risk undergone in handling them. Under our present system of exchange, domestic and foreign, the largest transactions can be adjusted with absolute safety to the interests of all concerned with a celerity which is marvelous and at an expense which is minimized to cheapness. For instance, we see transactions involving millions upon millions treated under our present system of foreign exchanges—credit—with as little concern almost as that with which the ordinary man purchases an overcoat.

(2) Credit, in taking "the place of corresponding amounts of gold and silver," performs another useful function; for, as Professor Conrad says, a saving is effected which permits the employment of these precious metals for other purposes. These other purposes are comprehended in that proportion of the precious metals used in the arts, and it is impossible to compute the effect which the introduction of these elements into the arts has upon the culture of the people. Employed in this form, they call for a character of workmanship which must be of the highest skill and proficiency, and the requirement of such skill and proficiency produces an appreciable effect upon the mechanical genius of the times. Further, the use of the precious metals in the arts affords employment to a great body of helpers and auxiliaries whose wage-earning capacity provides new sources of con-

sumption for the product of the labor of other fields and enterprises.

(3) Credit as a means of employing capital more productively. This thought is in harmony with the views of Mr. Mill (who preceded Professor Conrad), set forth with great distinctness in his "Principles of Political Economy." It is certainly an immense advantage to those who have little or no capital of their own, to be able to call upon those who are plentifully provided, and thus secure the means with which to embark in business. They may realize therefrom a return sufficient to not only pay the interest on the capital borrowed, but also a fair return of interest on their own investment, and a profit from the net results of the business. Credit, in bringing about the lending of money or other form of property or credit to those qualified to use it providently and successfully in business enterprises, has conferred an inestimable blessing upon mankind. The benefits accrue not alone to him who borrows, but to him who lends, for, as Mr. Mill so pungently says, "if it were not for credit, many people who possess capital but have no means of utilizing it themselves, would find it useless and profitless," so that the influence of credit works doubly to benefit him who lends as well as him who borrows.

(4) The benefits which credit confers upon the laborers or artisans or traders who through it secure capital to assist them in their efforts to work out a livelihood. This idea, as Professor Conrad explains, is of particular application to the organizations known as credit unions and which are the subject of the article by Professor Ely, already referred to. A word as to these credit unions will be useful in explaining the fourth advantage or bene-

fit of credit. The German Coöperative Credit Unions are the product of a coöperative society founded by Herr Schulze (Schulze-Delitzsch) in 1849, which had for its object the purchase of raw material among certain interested tradesmen. From this small beginning has grown a really vast system of coöperative banks. Schulze-Delitzsch wisely provided in the very commencement of these enterprises that those who wished to avail themselves of the loan advantages of the institutions must become members, and "they thus themselves indirectly furnished the security for the credit afforded them." These banks are credited with great success, and in 1892 were said to number 1,000, to have a membership of 500,000, and a paid capital of $30,000,000. They represent a very close analogy to our own building and loan associations, and it is not necessary to explain what a wonderful good has been effected in this country through the fact of men being able to secure the credit with which to provide their families with homes.

(5) Credit is a force in gathering together small sums by which "capital is concentrated" and its fruits distributed among the people. The savings bank is the principal means by which these small sums are accumulated and utilized as capital. By the system of savings banks and other forms of saving devices, these small and of themselves unproductive sums constitute a vast accumulation which is a striking addition to the capital of the country; and not only are they such an addition, but they are in such form that they can be made serviceable to promote the productivity of the nation.

(6) Credit, by the employment of "every sum, however minute," inculcates saving propensities among the

people. This benefit must be self-evident: First, there is the incentive offered of a return on the money saved; second, there is the encouragement, which a little earning will furnish, to strive for even better results; third, habits of thrift are developed in the people; fourth, independence of thought and action inevitably follow on thrift and economy.

(7) "Credit binds together the interests of those who have dealings with one another." Here we have expressed in another form a thought of Mr. Carey: that the existence of a system of credit is evidence that the people living under that system have faith in the good intentions of each other; a system of credit brings forcibly before men's minds the fact that it is an honor to be of good repute, and he who is of good repute in a business sense is he who is in good credit. To bring men together in hearty coöperation to accomplish the ends of business life and to make the possession and practice of sterling ethics a prerequisite to membership in the profession of business is a great moral uplift, or, as Professor Conrad expresses it, a "great advantage in the moral education of a people."

(8) Credit, as a means of making, through prudent saving, provision for one's family after death, illustrates the possibilities that present themselves for safely investing capital so that the income earned will represent a deposit from which running expenses may be drawn and the surplus of such income utilized in the form of additions to capital already acquired.

(9) Professor Ely has given us an insight into another phase of credit, viz., that it is the desire and expectation of those who seek and obtain capital to make it

produce a larger return than the mere interest to be earned, and this increment is really what in economics would be denominated profit. It is this expectation that leads men to embark in business, and to make investments even though the risks involved may be many and serious; and it must be borne in mind that this spirit of adventure in trade has had a very considerable effect upon the progress of commerce, and in the absence of that spirit many of the powers that commerce and credit have manifested would be latent.

While credit and the credit system have their benefits and advantages, they have their weaknesses and their evils. It is therefore essential to draw attention to the abuses which may generate in a system of credit, and from which there does not appear to be any known means of escape, if we are to accept the views of the great doctors of economics who have diagnosed the subject in every phase. These abuses are those which inevitably lead to commercial crises, and which all authorities agree would be obviated if men would simply regard the unwritten laws of prudence and good management; but as human skill, energy, knowledge, and capacity are included in the category of wealth, it is the veritable inability of laws of any character to control the exercise of these personal elements which renders the abuses of credit an almost unavoidable occurrence. The consensus of opinion is that the evils of credit may be said to principally manifest themselves in "speculation" and overtrading, which not infrequently lead to fraud, extravagance, and embezzlement. Some writers also claim that credit may be used to create a monopoly, and we do not have to go far in this day to see the truth of this claim.

The inevitable consequence of speculation and overtrading is failure to liquidate, and a general failure to liquidate means a panic. We are using here the homely word panic because it is the one most in use and also very descriptive of what really develops from the condition mentioned. It is patent that the credit system serves to encourage speculation, for under the workings of that system a man may pursue his way in business long after he is unable to pay in full; and, fighting off the evil day, he is engaged in a constant speculation with fate. Mr. Macleod has given us a description of this state of affairs which is exceedingly true to nature, as follows:

"All commercial crises therefore originate in the overcreation of credit, and this is innate in the modern system of credit. Suppose that at any time the commercial world started with a perfectly clean slate. When such multitudes of persons are trading on credit, it must inevitably happen that a considerable number will speculate unsuccessfully, and create an excess of credit, which cannot be redeemed by fair means. All excess of credit may be considered as so much virus or poison in the body commercial. However, by various tricks and devices known to traders, they can keep themselves afloat many years after they are utterly insolvent; and thus the poison continually accumulates. Then perhaps a fever of speculation takes place, giving rise to the creation of vast masses of speculative paper, and then, the poison having accumulated to a sufficient extent, bursts forth in a tumor or an abscess, called a commercial crisis."

To the credit system must also be attributed much of the extravagance that takes place in all spheres of life. Men who are known to be living beyond what is called their "means," or their earning capacity and income, are permitted to take advantage of the credit market and continue in their extravagances. This condition is respon-

sible for a great deal of the fraud and embezzlement that takes place, and much human suffering would be avoided if there were greater discretion shown in holding men fast to their "credit limits," by which is meant the establishing of a standard of credit-giving so high that only those who could reach that standard would be accorded the benefits of credit.

As to credit leading to monopoly, it is of course assumed that when this idea is advanced as showing an evil in credit, its corollary is that monopoly itself must be evil. This is, however, a suggestion outside the purview of this discussion. There are numberless instances where credit and the credit system have been utilized to create a monopolistic power. Whether these particular instances will develop for good or for evil remains to be seen. As an example, a man who is undoubtedly gifted with marked financial prescience, in a few years secured control of a great railway system almost entirely through trading on his credit. Our credit system not only permits such a circumstance, but the methods which have crept into the credit system encourage it. So long as the collateral offered is adequate, the system will survive; but when men acquire the power to influence loans of many millions, there is always the danger of their power assuming an arrogance and carrying with it demands that are not strictly safe or legitimate. It is against this possible danger that the credit system should guard.

Mr. Mill tells us that "credit given by dealers to unproductive consumers is never an addition but always a detriment to the sources of public wealth." An unproductive consumer passes the effects of the credit he receives to the powers of destruction.

There are some who assert that the world would be better without credit, and that the endless prodigality and speculation which it promotes would be avoided if all trade were upon a cash basis, or if, to go farther, we should reach that Utopian stage where the wants and the opportunities of men would be so regulated that the existence of money could be dismissed with commercial safety and with profit to the happiness and integrity of the individual. But it is not with idealisms we have to treat, but rather the credit system as we find it, a system which typifies an "inexorable law of political economy which cannot be resisted."

# PART TWO

# PRIMARY DIVISIONS OF CREDIT

## CHAPTER III

### BANKING CREDIT

It is not the purpose of this work to proceed with any extended dissertation on the subject of banking credit or banking. It is essential, however, that sufficient attention should be accorded to this "highest form of credit" in order to show its preëminent relation to and influence upon the commercial structure. Without banking credit the endurance of the commercial structure would not only be an unpromising but a negligible quantity. While it is true that commerce obtained and exerted a strong influence upon the development of civilization prior to the institution of what we now recognize as banking, it is only since banking became the leverage of commercial extension and activity in a modern sense that commerce has become the irresistible stream of progress.

Banks are the custodians and dispensers of credit in its universal sense. The exercise of this credit is not a personal, selfish possession, but a commercial trust. The business of the world cannot be accomplished without the dispensation of this credit. Natural as well as artificial influences and conditions justify this statement. Those entitled to credit should receive it without relation to personal or ulterior considerations, for unless this freedom

of credit is exercised the uses of credit are diverted from their proper channels.

It is not intimated that a bank is supposed to provide its customers with permanent capital. Such a presumption is at variance with sound banking and financial safety. Such a practice, if resorted to and continued, will reveal those false systems of credit which have produced such calamities in the world, and against the resort to which we have been so solemnly warned by the economists. It will not require much argument to show the inutility of a bank keeping its customers furnished with "permanent capital," for the thought is opposed to the very spirit of banking. Good banking credit is based on loans made with due regard to correct judgments; on collaterals that are subject to prompt and full liquidation; or loans consisting of paper, made and indorsed by persons of sufficient flexible means to enable them to honor their obligations without delays. To have large sums of money lent under conditions that the bank cannot avail itself of the proceeds of the loan with promptitude is an evidence of all that is reprehensible in banking. The bank must be in a position to cancel its own obligations just as a merchant must dispose of his, with this very marked difference to the disadvantage of the banker, viz.: a merchant may have a large amount of indebtedness falling due on a certain day; he may be accommodated by his bank with a credit sufficient to satisfy the demands upon him. If he be owing his banker, he may be able to secure an extension on the loan; if he be merely owing book accounts, he may be able to put off his creditors with what is a reasonable excuse for his nonpayment; but a bank, when it is called upon to discharge its obligations, *must pay*. Failure to do so

means its downfall; explanations, excuses, promises—none of these are sufficient.

Banks are said to be institutions "for lending, borrowing, issuing, or caring for money." While the caring for money may be the first interpretation of a bank's duty that would occur to the lay mind, still the "caring for money" must not be accepted too literally, for the stock or supply of money compared with the demands and clearings of the market appears to be a secondary consideration. As Professor Ely says, "Money . . . is entirely inadequate to explain the magnitude of present commercial transactions," for while in prosperous or normal times the disparity between the money supply and the gross volume of business creates no alarm and in fact attracts little attention, still our recollections are yet keen with the thoughts of the calamitous effects of the abridgment of the gold supply a comparatively few years ago. This condition, therefore, of relatively small money supply to great mass of business transactions is a species of phenomena with which scientists and economists have struggled for years, and so far with few satisfactory revealed results.

The very nature of banking business, which is almost entirely credit, puts into the hands of the banking community a power which it is difficult to estimate, and quite as difficult to cope with. How far-reaching this power has become may be realized when it is apparent that the ability of nations to undertake any very great enterprises or carry on costly wars is dependent almost absolutely upon the dispositions of the banks of the world. They can prevent war or they can enforce peace. Their dictum may mean either realization or disappointment for a people. Their

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tremendous, overwhelming power does not rest upon the fact that they are simply "care takers of money," but upon the greater fact that they are the manufacturers of credit, and the world submits to their drastic economic power with the docility of a child to a stern, unbending master.

Banks are divided into three distinct classes, viz.: Banks of issue or circulation, banks of deposit, and banks of discount. There are certain features of these classifications distinguishable in the very early history of banking, and it is undoubtedly from ancient practices that banks of discount and deposit have had their rise. The issuance and circulation of notes, especially a bank's own notes, having nothing behind them but the capital and character of those constituting the bank, is a development of the credit system. The method by which a bank of issue operates will be shown later. It is not material to this statement of banking credit to give a description of the historical beginnings and developments of banking: the latter, as we understand it, is the result of a series of experiments and vicissitudes running through the past four hundred years.

It has always been a favorite practice of a certain brand of politicians to decry the influence of banks in public affairs, and endeavor in every possible way to prejudice the popular mind against these institutions. People are likely at some time or other to become restive under the domination of an institution or set of men who are really beyond their control, as banks and bankers actually are. Nor are we losing sight of the fact that our national banking system, as well as that of England and other nations, is subject to legislative surveillance and

action, which, however, are usually spent when the laws concerning the creation and system of the banks are adopted. No legislature can expect to control the progress of these institutions and the power that by natural processes becomes theirs. This power has been, and probably always will be a target for loose-jointed reasoning and political agitation. As Hallam has pointed out, where the advice and wishes of the directors or protectors of the Bank of Genoa were interposed in public affairs, it was invariably in the direction of that which was healthful to the public weal. The same thing can be said in these days in respect to the advice and services of the banking community in public matters, especially in regard to the upbuilding and preservation of a sound public credit. Credit is a most delicate, sensitive quantity, and the banking business being credit in its highest sense, it must not only be treated with all the circumspection its very nature calls for, but it must also be protected from the attacks of those who, although animated by entirely sincere views, would do irreparable injury to the credit system in their desire to advance their political principles or ambitions. It is quite important that the public should be thoroughly educated as to the vast benefits that accrue to commerce and civilization from that species of credit dispensed by banks. Banks act as the depositories of the funds of the people, and exercise safe keeping over those funds. This safe keeping also involves the manipulation of these funds in the form of good loans or discounts at rates of interest which will yield a profit for the depositors. But further still, it means the employment of these funds in the channels of trade in such a manner as to bring forth the greatest results, and in this way to en-

hance the commercial credit, the wealth, and the enterprise of the community. Our attention has been drawn to the fact that the activities of banks have served to create a remarkable expansion in the field of credit which no other known influence has ever produced, or seemed likely to produce, and this also should be remembered when the potency of banking is under discussion. This expansion in credit has also been attended with considerable alarm on the part of some thinkers who cannot bring themselves to believe that it is the product of an entirely healthy growth; and on the other hand, they marvel at the possibility of a proper redemption of this vast ocean of credit. Mr. Macleod says:

"Credit always has to be redeemed and if this can be done, the Credit has been sound. Hence Credit is never excessive, whatever its absolute amount may be, as long as it always returns into itself."

The fact that no contingency is probable under which all this credit would have to be redeemed at one time is, of course, one of the great measures of safety to the credit system. The methods of that system preclude such a possibility, and the history of banking experience and practice has enabled us to understand this point with absolute clearness. Adam Smith explains this phenomenon thus:

"A particular banker lends among his customers his own promissory notes, to the extent, we shall suppose, of £100,000. As those notes serve all the purposes of money, his debtors pay him the same interest as if he had lent them so much money. This interest is the source of his gain. Though some of those notes are continually coming back upon him for payment, part of them continue to circulate for months and years together. Though he has generally in circulation, therefore, notes to the extent of £100,000, £20,000 in gold and silver may, frequently, be a sufficient

provision for answering occasional demands. By this operation, therefore, £20,000 in gold and silver perform all the functions which £100,000 could otherwise have performed."

It will be seen that while, as Mr. Smith says, twenty per cent of gold and silver are sufficient to sustain the amount of credit referred to, still a certain quantity or percentage of gold and silver is necessary to carry on general business, and the constant and easy circulation of coin wherever required serves to promote and support public credit and confidence. Montesquieu says that:

"Money is a sign that represents the value of all merchandise: Paper is the sign of the value of specie."

Paper is not only the sign of the value of specie, but when readily accepted it is a sign of the confidence of the public in the accessibility of a sufficient quantity of specie to satisfy business demands. The instant, almost, that the public comes to believe that the quantity of specie available is inadequate, then paper loses its mystic power, because the influence that upholds it has withdrawn its favoring protection.

On reading the weekly bank statements, the first thought that would probably occur to the uninitiated would be, How can that vast amount of credit be sustained by such a relatively small amount of reserve? The danger is an imaginary, not a real one, if the reserves be sufficient to respond to the demands which are likely to be made in the usual course of business, which, Mr. Bagehot contends, must be determined by the nature of the bank's liabilities.

The question with which this discussion most concerns itself is the relation of banking credit to commerce, which

practically covers the whole field of banking. The relationship of commerce to banking is evidenced by what are known as instruments of credit, or documents or advices of different forms and uses which can be made to serve as mediums of exchange in the very same sense that money is employed. The economic necessities which have created these instruments of credit are nothing more than the ordinary requirements and practices which are part of our daily business life. A merchant having purchased a bill of goods on a specified term of credit, gives to the seller a bill of exchange, drawn on himself, representing the amount of the invoice. The seller, needing money for his own business, passes this bill of exchange, with his indorsement thereon, to another from whom he has made a purchase, or to whom he may be in debt for any other reason. The third person to whom the bill of exchange is given passes it on again in liquidation of an indebtedness of his own, and so on. In this way that bill of exchange may serve in the effacement of many different accounts, and return to the drawer literally covered with indorsements. What is true as to the function of a medium of exchange, which the particular bill referred to has discharged, may be equally true of many other forms of credit instruments which may be called to mind. Promissory notes, drafts, checks, bills of lading, and warehouse receipts are all credit instruments which can be used as mediums of exchange or substitutes for money. It is in these several forms that loans made by banks are evidenced, and it is mainly upon the convertibility of these instruments of credit that a bank must depend to maintain its own credit in the discharge of its obligations to its depositors. In banking credit, therefore, everything

may be said to rely upon the character of the acceptances or collaterals which the bank receives in consideration of its loans, and it is proper, under the circumstances, to inquire, if only briefly, into the general nature of the credit instruments which are regarded as the more highly desirable and therefore safest. A leading writer says:

> "Notes, bills, drafts, checks, book credits, or any form of obligation resulting from a credit transaction, come into existence, not antecedent to, but as a consequence of, a transfer of goods involving futurity. Paper is purely fictitious and illegitimate which is not the outcome of an operation in goods; and we are enabled to test whether loans are legitimate, or not, according as we know whether the discounts are granted, or not, for actual transfers of salable goods. This test gives us the means of drawing the line between sound and unsound banking."

This statement draws the line of demarcation with a distinctness that leaves one in no doubt as to the view of the writer. However, to stamp paper with the title of illegitimacy stains its character. As a *large quantity* of the paper handled by banks does not consist of credit instruments that have their being as the direct result of "actual transfers of salable goods," it is pertinent to inquire whether paper not blessed with such origin is an evidence of unsound banking.

"A" is a retired merchant of means: his son desires to make a trip to a foreign country for the purpose of looking over some business propositions. He has not the funds, so he asks his father to give him his (the father's) note for $1,500, which he can discount at a bank and avail himself of the proceeds. "A" complies with the request, the note is given and used; the responsibility of "A" is unquestioned, and it is this responsibility which

the bank takes into account when it discounts the note. This transaction is not the result of an actual transfer in goods. Is it fictitious and illegitimate paper?

Another writer takes this view:

"When one wishes to borrow money upon his general credit, he makes his promissory note, which is in no way based upon particular property. But we may remark that notes are not negotiated in the market upon the goodness of a man's character or upon confidence in his honesty; but that they depend upon the maker's reputation for wealth and for regular payment of his debts, or, in other words, upon his commercial rating.

"In the commercial world, and with banks which discount notes, it is a part of the business to see that an ample amount of property is behind every note taken. An indorser is always required, and if the maker is at all unknown or suspected of financial unsoundness, another good indorser, or even more than one, must be procured; so that, to the lay mind, several times the amount of property promised by the note is readily available for its payment. One not accustomed to business is astounded at the requirements of a bank before it will discount a note seemingly perfectly secure. This is to make up for the remoteness and indefiniteness of the connection between the note and the property which may by law be ultimately devoted to its payment."

The opinions expressed in the last quotation represent the conditions under which many loans are negotiated. There has always been considerable discussion as to what constitutes absolutely real paper or fictitious paper. The gist of Mr. Thornton's estimate of the question is as follows:

"Real notes (it is sometimes said) represent actual property. There are actual goods in existence which are the counterpart to every real note. Notes which are not drawn in consequence of a sale of goods are a species of false wealth by which a nation is deceived. These supply only an imaginary capital, the others indicate one that is real.

"In answer to this statement it may be observed, first, that the notes given in consequence of a real sale of goods cannot be considered as on that account certainly representing any actual property. Suppose that A sells £100 worth of goods to B at six months' credit, and takes a bill at six months for it; and that B, within a month after, sells the same goods, at a like credit, to C, taking a like bill; and again, that C, after another month, sells them to D, taking a like bill, and so on. There may then at the end of six months be six bills, of £100 each, existing at the same time; and every one of these may possibly have been discounted. Of all these bills, then, only one represents any actual property.

"In order to justify the supposition that a real bill (as it is called) represents actual property, there ought to be some power in the billholder to prevent the property which the bill represents from being turned to other purposes than that of paying the bill in question. No such power exists; neither the man who holds the real bill nor the man who discounts it, has any property in the specific goods for which it was given: he as much trusts to the general ability to pay of the giver of the bill, as the holder of any fictitious bill does. The fictitious bill may, in many cases, be a bill given by a person having a large and known capital, a part of which the fictitious bill may be said in that case to represent. The supposition that real bills represent property, and that fictitious bills do not, seems, therefore, to be one by which more than justice is done to one of these species of bills, and something less than justice to the other."

It would appear that it is very largely upon the character, position, and wealth of its maker and indorsers that the acceptability of a note is determined. A note which owes its origin to "an actual transfer of salable goods" does not seem to derive any strength or merit from that particular fact, unless, as Mr. Thornton says, these goods are pledged as collateral for the payment of the note in the event of the default of the maker; and further, much might also depend upon the nature of the goods, their constancy in demand, their nonliability to

depreciation or perishability. It is not contested that in banking credit the quality of the collateral very often determines whether or not the loan shall be made; for many who could command little, if any credit, because of smallness of means and poorness of reputation, may be accommodated if they can produce at the bank acceptable collaterals. But, on the other hand, much of the business of banking credit is based on the general character, the ability, the means or wealth, and the reputation for prompt payment of the borrower and his indorsers. Mr. Bagehot remarks:

"There is a cardinal difference between banking and other kinds of commerce; you can afford to run much less risk in banking than in commerce, and you must take much greater precautions."

Every one will quickly recognize the force of this statement. The reasons why this "cardinal difference" exists are obvious. Banks and bankers are trustees for funds and other property placed with them for safe keeping. The fact that depositors entertain sufficient confidence in banks and bankers to intrust their property to them, imposes a responsibility which thoughtful, conscientious men will treat with a prudence indicating the highest moral purpose and endeavor. It is certain that the very essence of trusteeship is a rigorous regard for the interests of those who are the beneficiaries of the trust, and all this suggests an ability, a thoroughness, an economy, and a prescience in management which might not be followed with the same sense of exactitude in case one were simply merchandising or speculating with his own property. In addition, it is hardly necessary to call attention to the fact that the percentage of profits in banking is

smaller than in most commercial callings; and this emphasizes the need of extreme care in the lending of funds, for a loss in one case will wipe out the profits of a mass of transactions. The smallness of the profit also necessitates an advance in the rate of interest charged where some doubt may be felt as to the desirability of the loan. The bank exacts a greater interest charge in order to protect itself against the aggravated possibility of loss. This principle is so firmly embedded in banking and other branches of credit that it is accepted as a matter of course. On its face this seems an injustice—that the poorer man should have to pay the higher interest charge. The answer is that the rights and interests of the depositors must be safeguarded at all hazards; further, the man of lesser means is not the constant active force in the commercial world as is his more affluent neighbor, and the injustice spoken of finds its relief in the operations of the inviolable law of averages.

Adverting to the application of credit conditions in the relations of borrowers and bankers, there is assumed the consideration of what may be said to be a more practical phase of the study of credit, as differentiated from its technical or scientific character. The relations existing between the bank and its customers are synonymous with those prevailing between commercial creditor and debtor. In the latter case the consideration is a commodity called merchandise; in banking credit, a commodity known as money—both commodities representing degrees of value, one depending for its extrinsic value upon the ability of the merchant to dispose of his goods, and the other, money, apparently combining elements of intrinsic as well as extrinsic value.

In the case of the commercial creditor the property intrusted to the debtor invariably consists of goods or merchandise. When a bank affords an accommodation to a borrower it gives him the use of funds, this use being evidenced by a credit that is allowed him. Credit is also the determining factor in the transaction between the merchant and the debtor, for the debtor has a credit conferred upon him, and the creditor, in his turn, holds a credit or debt, which he has a perfect right to dispose of for his own uses, and in many cases does dispose of for the purposes of his business, realizing upon it the necessary means with which to prosecute that business. This analogy between banking credit and commercial or mercantile credit indicates the perfect workings of the credit system, which ramifies through all economic life. It is palpable that without the ministrations of banking credit the commercial system would be, as stated, "an unpromising and negligible quantity."

# CHAPTER IV

## CAPITAL CREDIT

THE second division of credit is capital credit, or the credit represented by bonds, mortgages, shares in incorporated companies, or other forms of long-time investments. The title given to this division of credit is in accordance with the nature of its functions. It differs from banking credit, the latter referring entirely to that character of loan business where the loans are of a temporary nature, as the vitality of banking business requires they should be. It will be recalled that any tendency on the part of banks to lend their credit or funds in the form of permanent capital was deprecated in the preceding chapter, and in this consists the essential difference between banking and capital credit. Capital credit means the employment of capital in credit transactions in a different form from that in which capital is invested in a business enterprise by those who expect to make that business their occupation and realize substantial rewards in the shape of profits.

It may be asked why general investors should not expect to be the recipients of large profits to the same extent as any other type of investor. The difference is this: where a few men invest their funds in a business, those funds invariably represent their entire available means or

wealth. They are working for themselves alone, and the profits of the business, whatever they may be, go to the owners alone. These owners, in order to reap this profit —which may be moderate or large, according to the nature of the business—have placed all they possess at the *risk of the business.* Its failure means their absolute impoverishment, with all attendant hardships. On the other hand, the general investor, who is seeking merely a nominal or reasonable interest upon the funds invested, is careful to so place those funds that his investments will be very well distributed, and should any one or two of them prove to be losing ventures, he has others upon which to depend for an income. His loss then, if any, is a partial one, while the man who has been seeking large profits and has failed will in all probability lose all.

One of the important things in which the people should be educated is to understand the fallacy of a large earning capacity for money—that is, a capacity beyond the well-known average earning rates of interest. They should appreciate that where rates above those which have a recognized standing are promised or guaranteed, if paid in any cases, it has been at the expense of the principal deposited, or by other dishonest means. Whether the rank and file, a term the expressiveness of which makes it admissible, can ever be educated to a comprehension of such conditions is problematical, but the effort should be made to accomplish so worthy a purpose even if the prospects be not assuring.

No matter to what element in the commercial or financial sphere we may direct our attention, we find it dependent on credit. It is a part of the inner nature of every branch of commercial or financial activity, and the

one strong reason for this is that in every case where a loan or an investment is made, the investment is made upon the belief of the party acting that he has reason to rely upon the solvency, the soundness, the permanency of the credit of the person or institution with whom he is dealing, and he displays that "confidence upon which credit is grounded."

Capital credit or investment credit arises from perfectly natural but exacting forces or causes. In times of prosperity, or a normal state of the commercial system, it makes its presence felt with an ease that no artificial influences could account for or command. In fact, in such times it needs no prompting to show itself and display its energies. Whenever want of confidence finds its way into the market, with lightning rapidity investments are withheld and capital seeks the storm cellar.

The reasons for making investments may be briefly stated. First, capital unemployed involves insecurity. It may be deposited in hands which through some unlooked for happening might prove to be unreliable. Hoarded near the person there is all the danger of fire or thieving, and the security of capital demands that it should not be left subject to any of these contingencies, but placed under auspices where the possibility of danger and loss are minimized. Second, capital seeks a spot where its utilities may be exercised in yielding a reward in the shape of a reasonable interest for its owner. Capital which is not earning a reward is useless in every way. It adds nothing to the income or means or prospects of the owner or of the world at large. The interests of society require that capital should be invested, not only that its owners may have the means of support which its earning capacity will

provide, but that the social system may have the benefits of its existence. Third, the productive capacity of the world will be strengthened and augmented by the use of capital. Its non-employment imposes upon such capital as is active an abnormal burden, subjecting it to too large a share of the responsibilities and toils generated by the demands of society, unduly sapping its vitality. On the other hand, a general and steady employment or investment of capital distributes its burdens and responsibilities in a manner that effectively promotes an evenness and fullness of productivity to the betterment of all mankind.

The next step is to investigate the avenues through which investment funds are mainly drawn. In his lecture on "Investments," Mr. D. R. Forgan, Vice-President of the First National Bank of Chicago, explained these sources in the following very descriptive summary:

"1. Savings banks' deposits, representing not an expansion of commercial credit, but the savings of the common people.

"2. That portion of the deposits of commercial banks which represents the accumulation of the profits of business and which may be withdrawn from business.

"3. The funds of life and fire insurance companies.

"4. The funds of educational, charitable, and benevolent institutions.

"5. The funds of estates in cases where the executors decide to exchange the assets at risk of general business for permanent investments, which call for no business management on the part of the owner.

"6. The funds of retired business men who follow the same course for similar reasons.

"7. The investment accounts of commercial banks maintained for the purpose of having some assets which can be converted into cash immediately in case of need.

"8. That portion of the increment derived from former investments which the holders do not spend."

The availability of these funds for investment purposes is predicated upon the very reasons set forth, as, (1) Security, (2) Earning Power, and (3) The Assistance of Productivity, and very little thought on the matter will show how cogently these reasons influence those in charge of these numerous and very diverse sources, to provide themselves with the best character of investment the market affords. Another very strong reason why people or interests desire to invest their ready capital in reliable and well-earning enterprises is the fact that the capital, having been so disposed, relieves them of the necessity of giving it personal supervision, and their parting with it involves an immediate and radical change of supervisors or guardians. In many cases this change is advisable and desirable. It may be that a man has no longer the capacity with which to apply himself to arduous business duties, and the fact of his being able to secure for his capital a safe home where it will earn for him a steady income, not only relieves his mind of a great strain, but affords him a revenue which is sufficient probably for his needs, and all without the necessity of his unduly risking or impairing that capital in the slightest respect.

Having considered some of the reasons for the prompt, steady, and safe investment of funds, it is in order to review the different forms of investment which are usually employed. These forms cover a wide range of natural, financial, and industrial forces, but as far as the elements of capital credit are concerned, the same requirements and

influences apply. These forms of investment are usually the following:

A. Bonds and mortgages, real estate.
B. Government bonds.
C. State bonds.
D. Municipal bonds.

Public-service utilities, as,

E. Railroad bonds and shares.
F. Municipal street-car-line bonds and shares.
G. Telegraph and telephone securities.
H. Gas and electric lighting securities.
I. Waterworks bonds.
J. General industrial securities.
K. Bank and trust company shares.

Investments in bonds and mortgages covering real estate have long been, and probably will always continue to be, a favorite recourse of capital. Real estate is to a great extent the oldest form of investment.

The modernity of corporate credit proves the motherhood of real-estate investment or credit, and it is likely that for the purposes of a large class of investors this motherhood has powerful attractions. Mr. Macleod has advanced some very interesting theories on the question of what he calls "property in land," especially in respect to the subject of credit, and submits this proposition:

"Suppose that we saw a piece of land on which there were actually existing products of the value of £3,000. Suppose that we wished to purchase that piece of land. Would the owner of the land be content to sell it to us for £3,000? Most assuredly not. He would say that though there were only products of the value of £3,000 on the land in actual existence at the present time, yet that land would produce a similar amount of products to the end of time. He would say that we must purchase not only the right to the existing products of the land, but also the right to the annual

products of the land to the end of time—that is, an infinite series of future products which will only come into existence year by year."

"Thus property in land consists of two perfectly distinct parts: the right to the products which *have already* come into existence; and the right to the products which *will* only come into existence in *future*."

This statement of the matter, which is authoritatively fundamental, proves that in real-estate investments much depends not only on the present value of the land and its appurtenances, but upon the possibilities of an enhancement in value. These possibilities are represented by the actual produce which the land may bring forth, and also its adaptability to other elements of improvement, such as manufacturing or even dwelling purposes. The point which determines this improvement is the desire or demand for its utilization in a way that will lead to an advance in earning capacity. This earning capacity is represented economically by the productive opportunities or enhancements obtainable. Therefore, the productive capacity and enhancements in value typified by earning power, represent, as Mr. Macleod claims, "the credit of the land." The possibilities for improvement in value, i. e., earning power, are certainly of the greatest moment where an investment in real estate is contemplated, although they are very often not given deserved attention. The transaction usually hinges upon the percentage of margin represented in the loan (the leeway being from forty to fifty per cent) and the probability of this margin being sustained during the life of the bond and mortgage. Where such securities are permitted to run for a long term of years, it will be seen how important it is that the "credit of the land" shall be not only a well-sustained

one, but an advancing one, in order that the ratio of margin may be constantly increasing, thus insuring the greater safety of the principal at stake, and where a piece of property is yielding steady and strong profits, the better capacity there will exist for the prompt payment of interest and other necessary charges. Further than this, when values are advancing with steadiness, there is the opportunity of securing larger advances of capital for the promotion of its productive power, involving a progressive state of the world's wealth, economically and socially.

From all this must be eliminated, as having any proper relationship to wise investment, the placing of loans or capital in quarters which are under or subject to what are called "boom" conditions. This is simply a species of the wildest speculation, in which the element of tangible credit in the land is entirely lost sight of, and people operate in land in the same reckless manner as they enter into other speculative ventures. No character of speculation, when its force has been spent and "the bottom dropped out," leaves a community in a more impoverished condition than that which obtains in the proverbial "boom town." It is true that the most substantial fortune which has ever been created in this country is the result of land investments, but this fortune represents not the results of "speculation" but the most prudent character of capital investment, and its vast increment is a tribute to the financial genius of the man who foresaw this "credit in the land." Possibly some exception will be taken to the statement that this fortune is the most substantial that we know of; but is the point subject to argument? It is not the greatest fortune in volume, by any means, but it represents certain natural forces which are not liable to

the shrinkage that is apt to overtake other great fortunes any time; it is not subject to the intense jealousies the volume of other great fortunes has aroused; it is not subject to the constant criticism, espionage, and attack from legislative sources that other fortunes must constantly cope with; it is not amenable to the imminence of government regulation, and possible government ownership which other interests must face, with a consequent diminution in earnings, for the inevitable tendency of government regulation is a reduction in charges to the people, and this will involve a reduction in returns to the investors in many different forms of public-service utilities.

The second of the stated series of investments are those known as national, state, and municipal securities. It is purposed to extend to these branches of capital credit a more specific description in the succeeding chapter, to which they are more closely related, but their mention at this time is essential to an orderly statement of the usual proclivities of those who invest their capital. These investments are graded in proportion to the "credit standing" of the different governmental entities from which they emanate.

Next in order may be named investments which belong to the family of public-service utilities. The latter term is not always employed in the broad sense that would cover great national railroad systems, express companies, or domestic marine facilities, which are more generally referred to as "common carriers." The investment in bonds and shares of railroads is one of the most popular forms of capital credit, although the shares representing both preferred and common stock of these corporations are the basis of the greatest system of public gambling the

world has ever known. The bonds of strong railroad companies are among the best investments, but there is necessity for caution in respect to even them, which is illustrated in the requirement of certain States that the bonds of railroads shall only be available for investment purposes on the part of savings banks (than which there is no more sacred trust) on condition that the roads shall have acquired and preserved for a specified period a certain average interest-paying capacity. This well-considered and necessary legislative requirement has established a standard of credit which the management of every road naturally desires to enjoy, and it imposes not only the responsibility but the incentive to reach the required state which will give the corporation the standing and reputation involved in the condition laid down.

There are many different elements which enter into the credit standing of a railroad corporation, for it is upon its credit standing that it must depend for a prompt and effective sale of its securities. A short time ago one of the great railroad systems of this country, contemplating a vast scheme of extensions and betterments, announced a very considerable issue of new stock. There were some who thought that owing to certain unhealthful conditions of the market this was an ill-advised undertaking. In the face of much public pessimism the securities offered were accepted and assimilated by the investment market with an alacrity that was pleasing as a measure of general financial confidence, but also highly complimentary as well as advantageous to the reputation of the particular railroad in showing that its credit was of the most stable character. Among the qualities that contribute to the credit of a railway corporation, and, as

a corollary, the desirability of its bonds for investment purposes, may be mentioned:

(1) The extent and value of its holdings.
(2) Advantages of environment:
  (*a*) Agricultural.
  (*b*) Manufacturing and commercial.
  (*c*) Municipal.
(3) Convenient and good class of railroad connections.
(4) Management.
(5) Equipment.
(6) Service.

(1) The real property of a railroad is one of its substantial assets. This real property may consist of rights of way and termini, and also considerable tracts of land abutting the rights of way. This property is very often acquired by subvention from the government or locality through which the road is passing, and it is also an object to a great railroad to possess valuable lands on its route so that it may be the beneficiary of their productive capacity: for instance, mineral lands and timber properties. These not only redound to the benefit of the road through profits acquired from leasing or selling them to others who may desire to operate or exploit them, but through the revenue derived from the business of moving the products of these different chambers of industrial activity.

(2) The nature of a territory through which a railroad operates is a vital element in its success; a road traversing an arid country with few manufacturing interests, and not touching any important commercial centers, is a proposition doomed to failure. The latter picture may seem to be an extravagant one, but it is not, as there

have been many such. As a rule, these untoward enterprises are projected with a view to finally connecting with or forming a link of some already well-established road, or one having considerable promise, and in that way ultimately bringing about an association that will be an advantageous one. On the other hand, a road passing through a richly agricultural domain, with important cities and manufacturing utilities to draw from, taps the vitalities of these sources of trade, and the freight and passenger business acquired is a valuable one. A word as to the influence upon a railroad enterprise exerted by its proximity to leading financial quarters. The element of contiguity is a powerful help in the maintenance of a good reputation and enables a road to market its securities to great advantage, other conditions being equal. It might be said that so large an amount of foreign capital being represented in the holdings of American railroads would be a contradiction of this theory, but it does not affect the question, distribution of capital being an economic necessity and practice.

(3) Desirable connections are a necessary adjunct of successful railroading, for they contribute to the comfort of individuals and also expedite travel, as well as secure quick transfers of freight. They are also an enabling influence in the promotion of closer and better business arrangements with other roads, which, necessarily, have a great bearing upon the opportunities of the road for transacting its business.

(4) The quality and influence of the management of a railroad depend entirely upon the question of personality. When one considers the number of enterprises, railroad and other, which fall into disrepute, bringing loss

and sometimes poverty to investors, the necessity of good management is manifest. It will be no answer to say that in great corporations (railroad and others) the *systems* evolved for their management will largely carry the business through, for no system, however well considered, ramified, or specialized, will be adequate unless directed by the highest type of human ability. Every day produces some new necessity in business administration, and the greater the business, the greater will be the necessities. These necessities cannot be met and solved by system alone. System is an inanimate thing; it may serve for a time to regulate; it cannot devise, invent, or create.

(5) The character of the equipment is another important feature of a railroad's standing and earning power—and this refers to freight as well as passenger facilities. Good equipment promotes safety and comfort, and these are considerations entering into the calculations of people in determining the character of a railroad. A road having a reputation for poor forwarding and dispatching facilities, for accidents and wrecks, with much loss of life (and also loss to itself in equipment and damage penalties), loses in character and injures its credit. It may be pointed out that accidents and wrecks are, to an extent, an inevitable consequence of railroading, that provision is undoubtedly made for them in the preparation of budgets; also, that some very important roads have had extremely serious wrecks attended with an undue percentage of loss of life, and that it does not impair the value or marketability of their securities. There no doubt are instances of this character relating to some very powerful and long-established systems, and while their unfavorable

experiences may not seem to have had any appreciable effect upon the marketability of their securities, the balance sheet must have been affected to the extent that such losses would figure, and this, it will be admitted, has a direct effect upon the earning capacities of these systems.

(6) Service is a leading factor in the reputation of a railroad. Attention, kindliness, and courtesy popularize a road. In cases where a railroad has a monopoly of a certain territory, and takes advantage of this monopoly to so economize in its service and equipment as to cause discontent among its patrons, it is obvious that its reputation is to that extent impaired. This discontent may lead to the organization of a competing line, or an eruption of local feeling and influence in favor of some method that would cause a cessation of the monopoly.

It may be claimed that, after all, the balance sheet and no mere sentimental considerations determine the acceptability of a bond upon the market; but all these qualities or influences have a bearing upon the balance sheet.

In all public-service utilities the nature and assumed value of the franchise is a significant item. It lacks tangibility except as far as past earning capacity may enable one to determine upon an approximate value, for the breaking of a monopoly represented in the franchise, or a greater degree of competition where no monopoly existed, will impair the earning power, and in this way reduce if not almost obliterate the value of the franchise.

A railroad bond is supposed to represent the actual property of the road, franchises and all other property, corporeal and incorporeal. The following description, taken at random from a number of bond offerings, will

suffice to indicate the nature of the security behind a bond, although the character and volume of the collateral is a matter of individual and constant variance.

"The entire capital stock of the Rio Grande Western Railway is owned by the Denver & Rio Grande Railroad Company, eighty-five in cash having been paid for the Common Stock, and an exchange made for the Preferred Stock on the basis of eleven shares of Denver & Rio Grande for ten shares of Rio Grande Western. At the time that the Denver & Rio Grande acquired control of the Rio Grande Western the latter company was paying five per cent dividends on its $17,500,000 of capital stock. The above bonds are secured by a First Mortgage, either directly or by ownership of all their securities, upon 193 miles, and also a mortgage upon the rest of the mileage, subject to a limited issue of $15,200,000 First Mortgage 4's, due 1939, for the redemption of which, at maturity, bonds of this issue are reserved. In addition, the bonds will be secured by a First Mortgage upon any new mileage at the rate of not exceeding $20,000 per mile. This issue is further secured by a First Mortgage upon, and by deposit with the Trustee of, the entire issue of $10,000,000 Capital Stock of the Utah Fuel Company, acquired at a cost of between $5,000,000 and $6,000,000. The latter company owns and operates valuable coal mines in Utah and Colorado, covering about 36,000 acres, and estimated to contain over 200,000,000 tons of available coal. It has several hundred coke ovens in operation, and the market for this coal and coke includes the territory from Colorado to the Pacific coast."

The property covered therefore may be that of auxiliary or subsidiary roads, that of a cognate enterprise such as the fuel company referred to, as well as any new mileage acquired and constructed. The property and the credit of these different concerns are all pledged as security for an output of bonds.

The conditions affecting the class of securities under discussion may be said to apply to all public utility or service enterprises, and the merits they should possess have

been set forth with particularity for that reason. The same general principles would affect the securities of street-car lines, telegraph and telephone companies, gas and electric-light companies, and others.

There is another class of investments which during the past generation has assumed a leading place in capital credit, commonly referred to as industrials. Industrials represent productive enterprises, manufacturing and commercial, and hold an important place in the investment market. There is probably no class of investment attended with so much danger and at the same time one under which a better percentage of steady interest may be realized under proper capitalization and management. One of the demerits of the industrial school is illustrated by the fact that (incorporation being so easy and comparatively inexpensive) prosperous times induce many to undertake the formation of so-called combinations and individual corporations, and to simply flood the market with their securities. The one-day panic in the stock market in April, 1899, was due to an unwillingness on the part of the banks to accord full recognition to such securities, and this wise movement so early in the industrial propaganda has had a healthful effect. It is unnecessary to refer by name to the numerous and prominent failures to exploit certain industrial propositions during the period 1897–1902, for the volume of undigested securities which figured during that period is sufficiently suggestive.

An industrial security is one that may be said to be nearer the people than railroad and other securities. One of the inducements offered to the small investor is to hold an interest in the company for which he may be work-

ing. This temptation appeals alike to all classes, officers as well as employees of a corporation, and is one with considerable force to it. The thing to guard against on the part of small investors (as many employees of such a company would necessarily be), and general investors as well, is the danger of making an investment where the returns are not permanent or are likely to be unduly affected by untoward trade conditions.

The basis of capitalization is a vital one with any character of corporation. The industrial corporation is one in which overcapitalization is most generally practiced, and it is hard to determine just how *much is* or how much *is not* water. In fact, the mania for large and high-sounding figures is such that actual values as a basis of capitalization seem to many a financial anachronism. The question of the proper basis of capitalization is one that cannot be hastily decided, and one also dependent on many conditions; each concern must be judged by the circumstances surrounding it. Professor Jenks, in " The Trust Problem," has given this subject a very impartial judgment, and says:

"It is generally assumed that the actual cash value will represent fairly well the cost of the reproduction of the properties in present condition together with needed running capital in the form of cash on hand. Such an issuance of stock in an ordinary manufacturing business, under conditions of fair competition, will give dividends in the long run probably not materially different from, but perhaps somewhat higher than the usual rate of interest in the community."

"On the other hand, most business men are of the opinion that the value of any property depends upon its earning capacity, its value as 'a going concern,' and that it is wise and just to issue stock of a corporation on that basis."

"Attention is frequently called to the case of a newspaper with a tangible property of, say, $100,000. Such a newspaper, ably edited, with a strong constituency of subscribers and a large advertising patronage, might readily pay good dividends on $1,000,000 or more. Why should not the capitalization not be placed at $1,000,000 regardless of what the plant might cost? The earning capacity may be due largely to the skill of the editor, or to the fact of connection with some political party, or to the peculiar business skill of its advertising manager, or to the good will gained through many years of skillful catering to the public taste. Why, it is asked, should not the capitalization be made upon its earning capacity rather than on the reference to the cost of the plant? . . .

"Even capitalization at the reproduction value of the plants may be as misleading in many ways as capitalization on supposed earning capacity, because unskillful management or a changing state of the market may either double the value of the plant or halve it within a year or two, if we are to take as the basis of value what it might actually bring in the market, which depends again, . . . on its earning capacity."

There are strong arguments on both sides of the question, and it is not proposed to make any extended investigation into this branch of the question. It should not be difficult to decide as to whether the bonds of an industrial corporation are reasonably protected and therefore reasonably safe, but the greatest sin committed in the name of industrial finance is the issuance of a mass of preferred and common stocks which have little if anything of collateral strength behind them. These stocks can be said to be without a "credit basis," and such being their character, they should have no standing as investments. On this point Mr. D. R. Forgan expresses this opinion:

"Common stocks composed entirely of water and given away as a bonus to help sell the preferred cannot be classed as investments, and many of the preferred stocks represent so extravagant capitalization that they also should be avoided."

The elements of safety to be studied in capital credit are: (1) the subjective nature of the enterprise; (2) its character for permanency of demand; (3) the actual value of its holdings; (4) the comparative value or merits of its franchises, patents, etc.; (5) its ability to earn a reasonable and steady interest on the investment; and (6) the character of its management.

# CHAPTER V

## PUBLIC CREDIT: NATIONAL, STATE, AND MUNICIPAL CREDIT

THE different races of the earth are represented by many diverse forms of nationhood. Where the advancement in business economy, in the arts, the sciences, and other indications of a progressive civilization are of a marked character, the nations so distinguished must look to credit as one of the great enabling influences in their efforts to achieve commercial supremacy and, its concomitant, national glory. This applies especially to the requirements of modern times, for it is an incontrovertible fact that to-day any nation which is not in high credit and therefore able to command prompt financial aid for such undertakings as may seem necessary or advisable—viz., war, great internal improvements, acquisition of foreign territory, or any of the numerous sources of activity which are part of the life of every great country, will find her course to progress blocked, and national retrogression a result.

Attention has been called to the power of the banking community in directing as well as almost regulating the affairs of the world; and the nation which has incurred the displeasure of that great power labors under tremendous difficulties. The moral aspect of any people will be re-

flected in the character of their credit as a nation. The basis of public or national credit is relatively the same as that of individuals or small-sized collective bodies or the largest corporations.

High credit is indispensable in modern society, not only on the part of individuals but nations, for without it the intensely exacting demands and necessities of this age of specialized endeavor cannot be satisfied.

Wherever there is credit there is debt. If it were not for the latter there would be no necessity for the former. It is the duty of commanding the use of certain things that brings credit into play, and it is also this duty that is the genesis of a debt. The word duty is used in order to distinguish the desires which find their source in legitimate necessity from those which are the offspring of mere caprice, whim, or pleasure. When the use of credit is invoked because of the latter, and sustains the slightest overstraining in order to gratify them, there an abuse of credit has taken place, with a corresponding loss to the productive functions of capital.

National debts are not of great age, for generations themselves are but milestones in the life of a people, and the debts of the foremost nations of the earth are the product of the past two centuries. That of England dates from the last decade of the seventeenth century, or from the period when there were firmly laid the foundations of that national supremacy which she has since so effectively maintained.

The causes leading to the creation of public debts are "war expenditures," "public works," and "funded debts." Expenditures for war purposes have always been the most burdensome that a nation has to meet. The capital

which is utilized in the prosecution of a war (especially one of the modern character, where the outlays run "into a million a day") is capital the use of which yields nothing in behalf of the productive welfare of the people. Let us consider what a blessing it would be if the funds which have been consumed in conducting the Russo-Japanese war had been used by these nations in the productive arts. Think of the vast new acreage which could be opened, the splendid results which the application of modern agricultural tools would produce, the great factories that could be constructed, the new industries introduced, the incalculable knowledge imparted to the people so that they might be competent to proceed with the vocations which this new capital would provide, the new schoolhouses that could be erected and the instruction diffused.

The causes leading to public expenditure are more pressing in the modern than they were in the ancient or mediæval eras. The cost of war is greater, notwithstanding the greater ease of communication by land and sea. The efforts to promote national enterprise, comfort, and health lead to more exacting demands in the nature of public improvements or public works, and the constant accretion of expenditures which overlap the provisions of budgets and legislative appropriations creates a floating debt which in time must be "funded" or made part of the "permanent" debt of the nation.

The greatest care must be observed in the appropriations of money for public purposes, because of the possibility that there may be a fluctuation in the revenues collected. This fluctuation may represent the collection of a larger amount than was anticipated, or a much smaller

one. If a larger amount be collected, it means that a surplus will be created, with all the danger that this surplus will lead to prodigality and reckless legislation. If, however, there should be a deficit, it means that unless the government has ample funds in its treasury to cover it, money must be borrowed for that purpose; and when a government has to borrow money for normal expenditures, it indicates that it is living beyond its means, and an impairment of its credit is the consequence. At the close of the fiscal year, ending June 30, 1905, our Government had a deficit of $24,000,000; but this amount was easily replaceable from its general fund, and the fact that the deficit had been anticipated for almost a year, discounted any unfavorable comment its appearance would possibly suggest.

The theory has been advanced that great public debts are a healthy sign and denote that the nations owing them must be very active forces in the world's affairs, and further, that they must be in high credit; to be able to create large debts presupposes good credit. This theory has been very determinedly attacked from some influential sources that have not hesitated to apply to it severe criticisms. A large public debt means a correspondingly large interest payment, which must be derived from taxation.

There is not the slightest doubt that the ability to create large public debts leads a nation into extravagance. If the people are uncomplaining, and money can be borrowed easily, those who have charge of the question of appropriations will not exercise the same prudence as they would if held to strict accountability. Economists also demur at the creation of great public debts, for the

plausible reason that funds which a government absorbs for its own purposes are withdrawn from other fields where they might be utilized in promoting the productive arts. The damage incident to this condition is apparent in the repression of productive capacity. The interest of the people is withdrawn from this essentially necessary course of human action, and indifference to the strict requirements of economic design makes itself felt. It is obvious that a people schooled in the methods of productive capacity will be more industrious and saving, and become more independent of foreign help than a people that does not possess these traits. Hence every influence that tends to unduly divert capital from the commercial betterment and progress of the nation is to be deplored; to minimize this evil is the duty, and should be the special pride, of advanced statesmanship.

Having considered some of the shadows of the picture, it is in order to contemplate its lights. The necessity of maintaining a high credit, which every great nation must regard as one of its cardinal obligations, has the effect of imbuing the people with a deep sense of the responsibility imposed upon them both individually and collectively. A people that has the proper respect for its own position among the family of nations will endeavor in every possible way to assist the ruling powers in so disposing the capacities and wealth of the nation as to make them count to the greatest advantage in establishing and maintaining the nation's credit. The consequence of these sentiments is a spirit of pride in the national growth and position which cannot fail to produce an exaltation of national feeling and patriotism, all of which—providing it does not descend to Chauvinism—makes for national

progress. Again, it may be claimed, and with excellent warrant, that a people so imbued will accommodate itself to the necessities of the government, and, if necessary, will practice such economy and self-restraint, even in personal affairs, as will leave the largest possible measure of material and financial substance to be devoted to the purposes of the government, particularly in times of great national peril and trial. A splendid example of this phase of national life has been shown in the attitude of the Japanese people, who have not only established, but succeeded in maintaining, under conditions which most authorities were at first inclined to regard as discouraging, a public credit which is one of the marvels of latter-day history.

There are two methods by which a nation can exercise its credit: one by the sale of its bonds and the other by the issuance of its paper, redeemable and irredeemable. The bonds of certain governments have come to be regarded as one of the highest and safest forms of investment. They may or may not have any security behind them. Bonds which sell at advantageous rates, unprotected by any collateral agreements, indicate the advanced state of public credit the disposing nation enjoys. A favorite method of guaranteeing government bonds is by pledging certain revenues, such as imports and other taxes, as security for their liquidation. As an example of this character of bond may be mentioned an issue of the Japanese Government (July 8, 1905) of which the following is an abbreviated description:

£30,000,000
IMPERIAL JAPANESE GOVERNMENT FOUR-AND-A-HALF-PER-CENT STERLING LOAN,
(Second Series)
Due July 10, 1925.

With Option To The Imperial Japanese Government To Redeem All or Any Part On or After July 10, 1910, Upon Giving Six Months' Notice.

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SECURED BY A CHARGE ON THE TOBACCO MONOPOLY REVENUES OF THE EMPIRE, AS STATED BELOW.

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Created Under the Authority of Imperial Ordinances Numbers 194 and 195 of His Majesty the Emperor, Both Promulgated July 8, 1905.

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COUPON-BEARER BONDS IN THE DENOMINATIONS OF £20, £100, AND £200.

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Semiannual Interest Payable January 10th and July 10th, at the Office of the Yokohama Specie Bank, Ltd., in London, at its Agency in New York, and Through the Deutsch-Asiatische Bank, Berlin.

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Principal and Interest Payable in London in Sterling, in New York in United States Gold Dollars at the Fixed Exchange of $4.87 per Pound Sterling, and in Germany in Reichsmarks at the Fixed Exchange of Mks. 20.45 per Pound Sterling.

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The London Issuing Banks Make the Following Statements in Their Prospectus Which Has Been Approved by Korekiyo Takahashi, Esq., Vice-Governor of the Bank of Japan, the Duly Authorized Special Financial Commissioner of the Imperial Japanese Government:

"This loan is repayable at par, July 10, 1925, but the Imperial Japanese Government reserves the right to redeem at par all or any of the bonds on or at any time after July 10, 1910, on giving

six months' previous notice. Partial redemption to be effected by drawings, in the usual manner, at the office of the Yokohama Specie Bank, Ltd., London, and the New York Agency of the same bank, and in Germany at such agency or agencies as the Yokohama Specie Bank, Ltd., shall determine under the instructions of the Imperial Japanese Government. The loan is secured both as to principal and interest by a charge, limited to £30,000,000 and the interest thereon, upon the annual net revenues of the Imperial Japanese Government Tobacco Monopoly and subject only to the charge in favor of the prior Loan of £30,000,000. The Imperial Japanese Government has the exclusive right to control the cultivation and production of the leaf, and to purchase, import, manufacture, and sell tobacco. It thus possesses the entire monopoly of the tobacco trade within the limits of the Japanese Empire. THE ESTIMATED NET REVENUE FOR THE FISCAL YEAR 1905–06 FROM THIS SOURCE IS 32,011,072 YEN, WHICH AT THE EXCHANGE OF TWO SHILLINGS AND HALF-PENNY PER YEN IS EQUAL TO £3,267,796. 18s. 8d. THE ACTUAL RECEIPTS FOR THE FIRST QUARTER HAVE PROVED VERY SATISFACTORY."

The notice of which the foregoing is an excerpt was advertised in the New York papers under date of July 11, 1905. Two days afterwards a news item in one of the leading metropolitan papers announced that the loan had been largely oversubscribed. This shows the value of good credit.

While it is the custom among certain nations to indicate a payable date for bonds issued by them, it is generally understood that such securities will run indefinitely. This is not a disadvantage but an advantage to investors, for it enables them to make investments with a reasonable certainty that they will not feel called upon to disturb them; they can look forward to a continuous and steady income, and they also have the advantage that will come to them from any advancement in the value of

the securities. As long as the credit of the issuing nation remains sound, all the attributes mentioned are brought into play.

The second method to which reference was made was the issuance of paper, or the recourse to paper credit. The acceptance of the paper issues of a government with freedom and confidence indicates also a state of high credit, but it must be regretfully acknowledged that in no other form has "credit" been more persistently or violently abused than in the paper issues of different national and state governments. In this treatise it is possible to give this question only passing attention, but enough may be said to indicate the evils that have crept into and out of the system.

The difference must be noted between paper money secured by coin deposits, government bonds, or otherwise, and paper money which is simply put forward with either no promise as to its future payment, no interest-bearing covenant, or with such a character of promise as contains no substantial prospect of fulfillment. There is, or has been, quite a numerous body of our own citizenship who have held to the theory that anything in the form of paper issued by the Government is money, and good money. The basis of their belief (or heresy) is that the *fiat, the dictum, the declaration* of the Government gives to either paper or coin the value represented in the special denomination this paper or coin bears; and not even the trying and instructive experiences of 1893–96, when the impossibility of maintaining the credit of the Government and the credit of silver without recourse to humiliating expedients was fully demonstrated, has convinced them of the errors of their views.

Fiat money is described as:

"Inconvertible paper money, not even containing a promise to pay, but issued by the state with the bare assertion of its identity with true money, although no provision is made for its exchange for specie. . . . When a government is forced to this measure, the state of its finances is virtually bankruptcy. The name 'fiat money' was first given to irredeemable paper currency during the so-called Greenback agitation in the United States after the Civil War, from the claim of the Greenback party that the fiat of the Government could itself give value to a circulating medium."

Public credit can never be effectively maintained or promoted by any such system of paper currency. The interests of such credit require that every output of the Government should be so protected as to insure its liquidation, or that the quantity of such issues should be in proportion to the possibilities of honorable liquidation. The greenbacks issued by the Union at the time of the Civil War have for years been a source of great solicitude to those who have the credit of the nation at heart, and they were one of the causes of the financial troubles of the Government during the panic of 1893. That public credit depends on confidence to an unlimited extent may be illustrated by one of the phases of that panic, which former President Grover Cleveland has referred to in his essay on "The Bond Issues" in the "Presidential Problems." It is this:

"Another most important condition of mind among the people, however, grew out of, or at least accompanied, their acceptance of the redemptive sufficiency of the gold reserve as constituted. The popular belief became deep-seated and apparently immovable that the reduction of the gold reserve to an amount less than $100,000,000 would, in some way, cause a disastrous situation, and perhaps justify an apprehension concerning our nation's financial soundness. Thus

a gold reserve containing at all times $100,000,000 came to be regarded by the people with a sort of sentimental solicitude, which, whatever else may be said of it, was certainly something to be reckoned with in making our national financial calculations."

Reference has been frequently made to the sensitiveness of credit, and the foregoing passage from the pen of Mr. Cleveland exemplifies the great delicacy of the credit system. As he shows, the fear and distrust of the people was due not so much to their understanding of the *exact amount* that would be requisite to protect the credit of the Government, as to the fact that the arbitrary and probably unscientific figure established by Congress had been subject to an impairment. That this figure of $100,000,000 did not set any absolute mark of safety is shown by the fact that subsequent legislation by Congress placed the figure below which the reserve should not be permitted to go, hereafter, at $150,000,000.

Public credit necessarily refers to the credit used by all political divisions and therefore covers the credit of States and their subdivisions, such as counties, cities, townships, villages, etc. Professor Bryce introduces his remarks on " State Finance," in the " American Commonwealth," with these words:

"The financial systems in force in the several States furnish one of the widest and most instructive fields of study that the whole range of American institutions presents to a practical statesman, as well as to a student of comparative politics."

The diversity of interests, agricultural, mining, manufacturing, and commercial, represented in the States imposes just as important considerations for the judgment of the statesman as do those of the federal Government.

The fact that in all matters of strictly local concern the State has a free hand under the federal compact, makes the duty of each in advancing its own interests and maintaining its credit just as primal a necessity as if each State were an entirely independent principality and accountable to no one. The credit of the States has been subject to the same curses that have crept into other political organisms, and in some cases these abuses have taken the form of outright repudiation of obligations, from which the creditor is without relief. The national Government is a sovereign one; and in all matters where the Constitution does not define certain rights and duties as belonging exclusively to the federal Government the sovereignty of the States has not been impaired. This rôle of sovereignty carries with it an element of danger to those who purchase the obligations of a nation or state so conditioned, for it means that they may be at any time repudiated. Venezuela has obligated itself to pay certain sums to England, France, Germany, and Italy, and the customs receipts have been mortgaged as security for the payment of the amounts awarded by the Hague Tribunal. But a war between many nations might bring about a condition of affairs whereby the effects of this decision would be entirely upset. Treaties between nations are binding until they are broken. Where a nation forces another to do certain things, it is usually because of her superior strength, or because she has made it to the interest of the country with whom she is treating to do these things. It is either force or cupidity, and very seldom moral suasion, by which agreements between nations are effected. It is not a sense of legal obligation that impels such agreements. A sovereign state or nation is the sole

judge of what she will do or will not do. Enough has therefore been said to show the desirability of high credit on the part of nations and states, and one leading element of that credit will be the faith that the community reposes in the fulfillment of obligations. A state which has repudiated her guarantees at any period will hardly have as good credit as one that has always respected those into which she has entered.

The recital of the foregoing danger signals may be regarded as superfluous, but they are fundamental questions for consideration under the head of public credit. What would apply, however, to State securities in the matter of possible repudiation could not affect municipal obligations; for municipalities can be proceeded against in the same sense that individuals may, and compelled to respect their obligations. The propensity to extravagance on the part of municipalities has also been so pronounced that they are in many cases prohibited from incurring obligations in the shape of funded indebtedness in excess of a certain percentage of the gross valuation of all the taxable property of the corporation. This percentage varies, in some cases being ten per cent, in others two and a half per cent or two per cent, and in some States the cities are required to secure the sanction of the Legislature for any expenditure outside of regular running expenses. The need for such a requirement hardly invites explanation. Without such limitation those in control of municipalities and other subdivisions of the State would enter upon a reign of prodigality from the consequences of which the local government could not escape. This would prove not only a great burden to the people, but ruinous to the credit of the city. Debts which were the result of

waste and extravagance might stand for many years in the way of the institution of reforms and improvements which the best interests of the people would sorely demand. Many State and municipal securities are rated among the best possible investments, and the low rate of interest at which they can be marketed is proof of the excellent credit of the issuers.

# CHAPTER VI

## INDIVIDUAL OR PERSONAL CREDIT

THE most popular form of credit, popular in the extent of its practice, is individual or personal credit. The title "individual" has been applied to this branch of credit to distinguish it from the credit utilized by those who act as distributors of merchandise. The latter are undoubtedly fulfilling a public or quasi-public function, although the motives leading them to follow their different vocations or trades are purely selfish or personal. They are endeavoring to acquire a sufficient profit from the handling of the goods in which they deal to support themselves and their families, and if possible to accumulate a competence for use in old age. In the case of the individual or consumer the credit he secures is solely for personal reasons and uses. It brings to him those things he finds it necessary to possess for the purpose of sustaining life, clothing himself, and equipping his home with suitable comforts and adornments, of cultivating useful knowledge, and providing for his pleasures. All this has an exclusively personal function, or one for individual activities only, and thus it is alluded to and understood as "individual or personal credit."

Mr. Macleod defines "personal credit" as "a person's purchasing power over and above his money: hence,

credit is a resource and wealth cumulative to money." This refers more generally to the broad use of the individual's power and ability to exercise his credit in banking and commercial circles than in the direction to which a discussion of "individual or personal" credit tends, in its commonly accepted interpretation.

In order to further differentiate "individual credit" from the exercise of personal power or ability to control "credit" on the broader lines indicated, it is sometimes entitled "Consumptive Credit," on the theory that individual, strictly personal, or consumptive credit covers those phases of credit which spend themselves in the consumption or annihilation of necessities and articles of luxury as opposed to those utilities of credit which assume a productive or distributive character.

Individual or personal credit can be said to be the basest form of credit, in that it depends less upon a capitalistic or collateral basis than any other branch of credit. At the same time, as the earliest form of credit, it was the foundation of all the other divisions of credit. The theory of credit, and following that the system of credit, rose from the institution of personal credit. The latter is therefore of the most primitive origin, and is a product of certain natural influences, which, in turn, generated trust among the people as to the honest performance of engagements entered into, and the safe return of any property lent, either in its original or equivalent form as the contract might provide.

One of the best practical treatises on individual credit which has been written is that entitled "Individual Credits," by James G. Cannon, vice-president of the Fourth National Bank of New York. In it he has explained

in a most lucid way the basis, practice, and evils of this division of the credit family. Mr. Cannon claims that "the credit structure has been reared upon faith and supposition rather than upon tangible property and financial strength." As a criticism of the looseness with which the question of credit has been treated, the opinion is justified. It should not, however, be interpreted as a vindication of the idea that *goods*, and *goods* only, can be scientifically considered the basis of credit; for no writer among either professionals or laymen has done more to give to character and capacity, as personal elements, a more commanding place in the "dynamics of credit" than the able authority referred to. It is a timely warning that individual, and all other branches of credit, should be reduced to a systematic basis; and that the better defined the system, the safer will be the credit dispensed, especially in its influence upon the business morals of the people. The duty, therefore, which imposes itself upon business men is to "build a better basis for individual credits," in order that "the whole commercial edifice . . . be strengthened with benefit to all concerned."

Mr. Cannon says further:

> "The evils from which the mercantile community suffers seem . . . to be due, not so much to lack of money or capital, as to the lack of an intelligent and proper use of credit. If we can inspire a healthy public sentiment in regard to all forms of credit, it will serve greatly to facilitate needed reforms."

The elements of individual credit cannot be said to differ materially from those of the other divisions of credit. While the elements should be and in some cases are the same as in commercial credit, the fact is that in

a great mass of the individual credit practiced, some of these elements are wholly lacking. The nature of the economic and social position of the person is such that he cannot be expected to develop all these elements. In individual credit there is less system followed than in the other branches. The stronger the character, the earning power, and wealth of the applicant for credit, the safer the risk and the greater the freedom with which credit may be extended.

This credit is extended to a vast number of people. The task of classifying them is a most onerous one. Their earning power is a question of the widest possible variance, as is also the nature of their family responsibilities and demands. The mercantile agencies can with reasonable correctness classify all dealers, manufacturers, wholesalers, jobbers, commission men, and retailers under a brief table of cleverly devised classifications or ratings, indicating character, worth, and paying qualities; but the attempt to accomplish such a result in connection with the armies of labor and professional life would be an undertaking requiring long years of patient and unrequited service, leaving aside the tremendous financial outlay it would involve. Further, there is the almost insurmountable difficulty of holding those who dispense this credit to any code or set of rules; and this difficulty arises from the economic status of the credit seekers as well as from the number concerned. Here you have a great aggregation of credit dispensers, treating with all sorts and conditions of men, subject to all known phases of social and political advantage and disadvantage—the first demanding on their merits; the second commanding, from the very fact of their poverty and misery, such a share of the

materials for sustaining and improving life as their special wants and desires will suggest. Mr. Cannon, in the paper mentioned, inclined to the opinion, from which there will be no dissent, that one of the evils of the credit system, and particularly in individual credits, is the "too great liberality" in extending credit. This liberality is not due to any spirit of generosity or philanthropy, but is the outcome of failure on the part of those who extend credit to properly investigate and satisfy themselves as to the credit standing and desirability of the applicant. Very great advances have been made in the methods employed for making investigations and the means thereto have been greatly extended. This refers to all branches of credit; and while the omission to engage in such investigations may have been noticeably frequent in individual credits, there is no division in which it is more manifest than in banking credit. The credit department in the bank is the work of the past ten years, barring the days of those who blazed the way for its institution, and even to-day it is not as pronounced a feature in banking as it is in commercial circles. There is certainly no good reason why this should be so, for the volume of bank credits would seem to demand every care that could reasonably be extended to it.

The failure to make proper investigations in individual credits may be traced to a few underlying causes. (1) The cupidity of dealers in extending credit indiscriminately in order to do a larger business than their competitors. (2) The fear of offending patrons by asking entirely legitimate questions in regard to their means and prospects, and thus driving trade away. (3) The absence of sound knowledge on the part of dealers in re-

gard to the necessity of trusting their goods to those only who are so circumstanced as to relatively insure payment being made for them. (4) The lack of facilities among the great mass of dealers for making such investigations as are necessary.

A brief discussion of the foregoing reasons is in order. (1) The desire to overreach one's neighbor is not always due to abnormally selfish or unworthy motives. At the same time in the struggles of competition it should be borne in mind that unless the business done be a safe business, the results are bound to prove disastrous. A small business, with good collections and fair profits, is always safer in the end than a big business built upon unwise credits; for the latter not only invites commercial failure, but the mental and physical strain upon the dealer is a detriment to him both in a personal and business sense. (2) It is well known that consumers take advantage of the dealer's fear of the effect upon a customer's attitude because of questions regarding ability to make payment, and there are many who trade upon this very fear and defraud their creditors accordingly. A good presence, a bold manner, and an assertive method of expression have a powerful effect upon the mind of the local tradesman, and he gives credit without reliable knowledge as to whether or not his bills will ever be paid. Even when tardiness in payment may cause misgivings, he hesitates to offend that important personage, his customer, for fear his competitor will take the trade away. (3) The absence of knowledge on the part of dealers of the duty they owe themselves in making investigations of their customers' standing. This is a general condition and one attributable to lack of educational methods on the

part of those who dispense banking and commercial credit. The latter should make it plain to the retailer that he ought, for his own safety (and his safety means the safety of the banker and wholesaler), to satisfy himself that those to whom he is giving credit are worthy of it. The retailer's ability to pay the wholesaler or jobber, or to pay his banker for a loan, depends on whether he can collect his own accounts promptly and fully. If he cannot pay his creditor, the latter in turn cannot pay his, whether he be banker or manufacturer; and the falsity and unsoundness of individual credit and the losses attending it are reflected through the whole commercial structure with results that make for financial disaster. (4) The department stores and large retail establishments usually have employees whose duty it is to make necessary credit investigations. In addition to their own independent inquiries, they can avail themselves of the services of the mercantile agencies and other sources of credit information, such as retail mercantile agencies and coöperative agencies which they themselves maintain, and to which they in turn contribute such information as they may possess in regard to a customer when called upon to do so. The majority of dealers are without these facilities. They cannot afford to employ people for this purpose; nor to subscribe to the mercantile agencies, neither can they afford to belong to the coöperative bureaus. While the owner of the business might appreciate the necessity of making proper investigations, he cannot afford to give such work the necessary time. In a small business the element of time is a very important one, and has to be figured in dollars more frequently than in a large establishment where the volume of profits justifies a more

painstaking care for every business detail. Undoubtedly the dealer would save money by giving the question of credit standing more attention, even if to do so meant the omission of other duties.

That many people are given credit when they have little basis for it, or by their failure to make prompt payment have sacrificed their right to it, is a matter of common knowledge. That it is not an easy matter to obtain satisfactory information in regard to people who seek individual credit is a fact known to all who have had practical experience in credits. This difficulty should lead to the development of every honorable means for safeguarding credit extension in this form, and, if necessary, to the withholding of credit until satisfactory advices are secured. On the other hand, there are many people respecting whom it is possible to learn very little. A man on a plain salary offers little opportunity for extended investigation, and the opportunities of judging of the "moral" risk involved is difficult from the fact that little is known of him; as Mr. Cannon says:

> "You would be surprised to learn that some of the richest and most substantial houses in the larger cities will seek for data through the instrumentality of janitors of apartments, butchers, and tradespeople generally."

Closely related to the subject of individual credit is the question of the effect of credit on prices. The latter determine the cost of living, a question of vital importance to those who depend upon their earning power, as it is upon the consumer that the final and full effect of price changes manifests itself.

In a reference to credit as a creator of purchasing

power, attention was called to the view of Mr. Mill that "credit, in short, has exactly the same purchasing power with money, and as money tells upon prices not simply in proportion to its amount, but to its amount multiplied by the number of times it changes hands, so does also credit," thus having an effect (and an appreciable one) on prices.

Where, as in our country, credit is resorted to by the humblest, and is in universal practice by the smallest dealers, there must be some compensatory element for the interest on the capital represented in the amounts trusted out by them and which they thus forfeit, and for the losses from uncollectible accounts. This loss must be an enormous one when viewed in the aggregate. As expressed by Mr. Daniel B. Murphy, of Rochester, N. Y., in his paper on "The Objects and Possibilities of Credit Men's Associations" (April 17, 1900):

> "The entire story is not yet told. These stupendous figures (an average reported loss of $178,871,026.70 for ten years, 1890–1899) —appalling though they be—do not include the untold millions that are absolutely lost each year, by merchants engaged in retail trade, in every line of industry, in every town and crossroad, from ocean to ocean, from the lakes to the Gulf, comprising every retail enterprise, from the gigantic department stores in our great cities to the humble rural dealers. These figures do not include the very considerable loss sustained by those engaged in the learned professions—notably by the physicians of the country—nor do they include the enormous losses of a personal and confidential nature, that are not submitted to the gaze and scrutiny of the public."

The consumer must recompense the dealer for the loss to him of interest on capital and from spurious accounts; and this recompense is made to the merchant in the form of an advance in the selling price. Further, the very

nature of credit involving a deferrence in the time of payment, creates in the consumer an inclination to gratify his wants with a freedom that would be entirely lacking if cash were the basis of his dealing. In this way an extra, and it might be said an excessive, demand for goods is created; and this demand, not being at all times and in all lines or articles easily met or satisfied, produces an advance in prices. This advance the consumer must pay, and in most instances is perfectly willing to pay, for the reason that his credit enables him to prepare for the due date of payment, and he will discount the possibilities of the future in his desire to possess the things of the present.

Credit is sought for almost every want and desire of man. The range of credit functions begins with the actual necessaries of life and ends with the rarest forms of luxury. It is a debatable question whether those who seek credit for the necessaries of life, by which are meant food and other things absolutely required to preserve health and a minimum of comfort, are not more harmed than benefited by the credit they secure. In this class may be considered laborers, tradesmen, and mechanics who are working for wages payable weekly, semimonthly, or monthly. With the amount of a month's wages in hand at the beginning of a month, a well-behaved husband and prudent wife, held to cash payments, will accommodate themselves to their known means; they will not pay a larger sum for house rent than their income warrants; they will not indulge in luxuries that their means will not justify, but will endeavor to save something, be it ever so little, to form the nucleus of a fund for the time when the man, the provider, may be out of employment,

or sickness come upon them. Reverse the picture and put them on a credit basis and the gratification of their wants not being restrained by the necessity of parting with the cash in hand, but rather stimulated by the thought that Mr. So and So will wait for his money until pay day, the desire to secure some other boon which requires the outlay of spot cash prevails, and the thing is done. Mr. So and So does not get his money on time and the people are in debt. This is a very simple word picture of an everyday experience. Can it be avoided? Possibly not under our present economic system; but any measures of restraint which will curtail the evils of credit among this class of people, evils to them morally and financially, as well as evils to the dealer, should be invoked. One effective method would be to restrict the amount of credit to be allowed in a week, to insist upon payment when due on pain of a withdrawal of credit, and an agreement among the dealers that they will not extend credit to anyone who has been rejected on the grounds mentioned until a settlement is made. The so-called black list of the beef trust, as far as it referred to the withdrawal of credit from dealers whose undesirability was based on their failure to pay for goods, involved a necessary business policy.

There is one form of organized credit extension to workmen that should be mentioned, and that is the credit given through the so-called company stores conducted by large industrial and mining corporations. These stores are conducted with the idea that they will yield a profit, and the system employed as to charges has had the effect of causing great dissatisfaction among the employees. It is not an unusual experience that with the small wages

paid in many callings, at the end of the month or at the time when the wages are due it is discovered that the workman has nothing coming to him, as the credit he has "enjoyed" at the company stores has represented all and more than is due him. In this way workmen are kept continually in debt to the company, and a man becomes more like a serf than an independent workman. The prices charged workmen at the company store have not infrequently been the cause of disturbances between labor and capital, and the relation of individual credit, thus granted, to the great labor problem becomes an interesting study.

There is another very numerous class which is constantly in the market for individual credit. This class is composed of public officials, lawyers, doctors, clergymen, educators, teachers, architects, civil engineers, real-estate agents, insurance agents, bank clerks, salesmen, accountants, bookkeepers, etc. With these, other elements enter into the constitution of the credit than with the class recently discussed. These elements are mainly character and earning power and means represented in personal and real property.

Character has an important place in individual credit as well as in the other primary divisions. A man of good character can be depended upon to liquidate his indebtedness if it be possible for him to do so, although continued sickness or the loss of his position may frequently prevent his living up to his engagements as to time; but in such a case, when the debtor finds himself in a position to pay, he will do so. Further, a man of sound character can be depended upon not to live beyond his means nor to engage in dissolute and profligate devices. A salesman, in the

receipt of a good steady salary and possessing the element of character as it has been defined, will make a better credit risk than a person who is depending upon a small income from real estate, for the failure of a mortgagee to pay his interest promptly may retard the payments of such a person. Many lawyers, doctors, and others of those enumerated above are, as far as their earning capacity is concerned, better credit risks than small merchants; for their incomes are large and the very nature of their professions, being of a semipublic character, is an incentive to them to stand well in the community, and by this is meant to be in good credit. A thing to be remembered, however, in connection with professional men, insurance agents, and others of similar callings is the propensity to extravagance. Insurance men and salesmen, those of the higher grades, are compelled to do considerable "entertaining" as a means of acquiring and holding "business"; and this undoubtedly leads men into extravagant methods and high living. A man's taste for dress, pleasure, and his *associations* are all questions which have a very decided bearing upon his credit acceptability, and they should be carefully examined and passed upon before an account is accepted, and also looked into periodically during the continuance of such an account. Another point to be considered is the propriety of a purchase. Is there warrant for it? Is the person likely to require the character and quantity of goods selected? As Mr. Cannon has said:

"For instance, where a customer might, without criticism, buy a $500 house-furnishing goods bill, he might very properly be refused a credit of $300 for purchases made in the dress-goods department."

From all that has been said, it is apparent that the evils that have affected individual credit are chargeable, quite as much to dealers themselves as to the remissness of those to whom the credit is extended. Enough has already been adduced to show the general defects of the system; but there is one custom which has tended to generate abuses on all sides, and that is the failure of both large and small dealers to insist upon prompt settlements, or, as a penalty, the withdrawal of credit favors. That a great improvement has taken place in this respect during the past ten years is to be admitted and applauded. As far as the New York market is concerned, the credit for this improvement must be accorded to a man who, some ten years ago, accepted the position of credit man in a leading retail establishment. He came to the conclusion that one of the principal reasons for the backwardness of people in the settlement of their accounts was the long time to which customers felt they were entitled. This man, who had thoroughly educated himself in all the intricacies of commercial credit in its widest sense, proposed to his firm that an innovation should be introduced in the form of bills mailed promptly on the first of every month, and that it be specified upon the invoices that monthly settlements were expected. His suggestion was received, as might have been expected, with diffidence, but by urgent advocacy of his plan he finally induced his principal to permit him to make the change. This permission was granted, but with manifest pessimism as to the result. The outcome has been a revolution in the systems followed previous to that time.

"We will give you credit." This is the burden, and, in some cases, the exact wording of signs that challenge

the attention of occupants of street cars, and pedestrians, and which are found in attractive, well-worded advertisements in the newspapers. Credit for everything—household goods, furniture, etc.—at prices which fully admit of the long credit extended under chattel mortgage protection. To avail themselves of this credit and its so-called advantages, people place themselves under burdensome obligations, and—what is the worst feature of the transaction—buy more than they have any use for, more than they have a right to purchase, their means considered, and are led into expensive habits which are far more difficult to overcome than to acquire. Clothing is another item which retail houses are selling on credit, and the unfortunate part of it all is that those least qualified to afford such expenditures are led into making them.

Agents for jewelry, books, etc., go from business house to business house importuning the employees to purchase their wares, the favorite argument being, "You only have to pay one dollar or two dollars per month," as the case may be. Equally alluring is the advice of many advertisements, of one of which the following is a literal transcription:

> "To achieve success you must look successful. Use your credit. Wear a diamond. Diamonds win hearts. Diamonds increase in value twenty per cent per year."

What a person does not need or require, in the actual acceptance of these words, is not cheap, and should not be purchased, no matter how favorable the terms. The evil of all this consists not solely in the fact that those handling the classes of goods enumerated realize an abnormally high price for them, but that a large number who buy do

so in the exercise of extravagance, which leads to other things more reprehensible. Unable to pay, they leave their old surroundings, and strive to hold unjustly the property they have agreed to surrender in the event of their failure to pay for it. In arranging the price at which these goods are placed upon the market, due provision is unquestionably made for losses from various causes, and a faint idea may be gained of the percentage of profit figured in order to cover it.

The willingness of mercantile houses to extend credit manifests itself not only in liberal treatment to those who seek such credit, but it has become the practice actually to solicit patronage, offering the inducement of credit favors as a leading argument. This practice is not part of the general scheme to which reference has been made of the "We will give you credit" class, but representative concerns write nicely worded letters to a large number of people, stating that they were ready to open accounts with the recipients, or "we have placed your name upon our list for a running account, and will be pleased to have you avail yourself of it." It must happen that in this way a great many undesirable people are solicited, and their business accepted. The lists from which these names are taken are usually those found in "élite directories," than which no more unreliable basis could be thought of. These directories contain the names of people who reside in certain fashionable sections of cities, and it is presumed, evidently, that the mere fact of residence in such a section presupposes means and good paying qualities. To those who have looked into the subject and discovered the scrimping that is practiced in order to support the flaunting extravagance of many of these people, and usu-

ally at the expense of the grocer, butcher, milkman, etc., the folly of such general solicitation of credit accounts seems deplorable. It will not answer to say that even in the event of people taking advantage of these offers to open accounts, that when they are investigated and found not entirely desirable they can be refused. That is not the way the thing is done. A call is made in answer to the note of invitation: a few goods selected, charged, sent home; a little later another call is made, more goods purchased. Possibly, in the meantime, unfavorable information has been secured. The owner or manager or credit clerk of the house, with profound apologies, makes known the fact that the demon of doubt has entered his mind in regard to the desirability of the account. Then behold the virtuous indignation—the family honor impugned—the explanations, clever to a degree, especially if conveyed with the convincing subtlety of a bright-minded woman. Then Mr. Owner or Mr. Manager or Mr. Credit Man very often comes to the conclusion that his information may have been slightly biased—that it may have been unfavorably colored by a jealous competitor, then Milady gets the goods. It would be useless to maintain that the offer to give the credit in the first place *has* not had an embarrassing effect upon the house, for such an effect is undeniable.

"The age of luxury" is but another name for "the age of extravagance." To the extent that individual or personal credit is responsible for these conditions, remedial methods and principles, containing nothing of harshness or drasticity, should be developed and inculcated.

# CHAPTER VII

## COMMERCIAL CREDIT

THE field of commercial credit is represented by the demands and possibilities of trade interchange. Its scope is therefore an expansive one, extending in area as the influence of civilization becomes wider, and increasing in its activities as the volume of trade grows larger. Through the operations of commercial credit vast stores of goods pass from hand to hand, and finally reach their destined goal—consumption, in the natural course, or annihilation, as in the case, for instance, of the munitions of war. It is not necessary to recur to the vital influence of credit in the promotion of trade and the expansion of commerce, although in no respect are the forces of credit more thoroughly exemplified than in the commercial world. In commerce the credit system manifests its tremendous power in a manner that appeals more strongly to the understanding and appreciation of the individual than it does in other branches of business activity. This is due to the fact that commercial transactions are on a much larger scale than transactions in individual credit, and there is a greater degree of responsibility exacted by those who extend the credit; for this reason the means at their disposal for educating the people as to the proper requirements of credit are infinitely better. This condition makes

for a much safer basis of credit dispensation than would be possible if the necessities of commercial life did not impose upon those who partake of it a respect for the obligations of the credit system.

The channels through which commercial credit operates are various: (1) There is the raw material, largely direct from the bed of nature. This raw material must be conveyed to those who will weave it, or otherwise develop it, into fabrics or articles answering every known demand of the human family. (2) The finished or manufactured article is then to be turned over to those who have a market for it, or who have the ability and means to create a market for it. (3) The men of the market, in turn, dispose of this article in quantities according to the demands of the retailers. (4) The latter are those who cater to the multitude, the unit of which is the consumer, who typifies the last station or stopping place on the road of commerce.

Goods are moved through the different channels of commercial intercourse by the medium of credit. Suppose that the producer is not equipped with the capital necessary to conduct his operations, and is compelled to seek accommodation from his bank. This he obtains either on the score of the confidence entertained in his living up to his promises, or by providing the bank with security upon certain of his belongings or upon the finished product he is about to market. The manufacturer to whom he sells may be required to give his note to the producer. In this note the producer has one of the best bases of credit, viz., a negotiable instrument which the bank will purchase or discount, assuming that the credit strength of those whose names appear upon the note is of a satisfac-

tory character. This operation is continued through the entire commercial family, each succeeding recipient of the goods furnishing to the seller a means of carrying his account; and if the seller has not the available capital, he uses these means for the purpose of securing further credit without which he would be unable to continue his business. All trades require the use of considerable cash for the payment of employees and for other purposes; and this requirement imposes upon business men the necessity of making constant use of their credit. This is also required to effect the purchase of new supplies, to discharge maturing obligations, and to institute repairs and betterments in the business plant. It is the fact that few, if any, business establishments are so circumstanced, in respect to the necessary volume of available cash, as to be able to dispense with credit, that makes credit so indispensable a factor in commercial life. The limit of the volume of currency disproves such a possibility, and leaves the commercial public under the dominion of the credit system. It is apparent what a boon credit represents to business men, and how its absence would dwarf all attempts at extended business enterprises. Mr. Macleod says that the credit of which the producer, the manufacturer, the middleman, and the retailer avail themselves "is capital to these classes, and that it stands for use or enjoyment to the last class—the individuals and consumers." The latter have less recourse to credit than those who are actively engaged in business, for the reason that their wants are fewer and simpler. The currency of the country circulates among the consumers to a greater extent than among others, as wages and other small debts are paid in cash and not in instruments of credit. The

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consumers are therefore in a position to give cash or currency in exchange for goods purchased.

Commercial credit is the great pillar of the credit structure, for from commerce flows the ever-strengthening tide of wealth that finds its way into the different repositories for funds—either to banks for safe-keeping or into corporate or public credit for safe investment and income-producing purposes. If it were not for the life that credit gives to commercial transactions, and the constant interchange of goods it induces, there would be little necessity for banks and other financial enterprises. It is commercial credit that brings into being the vast quantity of instruments of credit, especially bills of exchange and promissory notes, which represent the great bulk of the business of banks. An example of the operations through which men find it necessary to depend upon their credit is admirably expressed in the following by Mr. Bagehot:

"The new trader has obviously an immense advantage in the struggle of trade. If a merchant have £50,000, all his own, to gain ten per cent on it he must make £5,000 a year, and must charge for his goods accordingly; but if another has only £10,000, and borrows £40,000 by discounts (no extreme instance in our modern trade), he has the same capital of £50,000 to use, and can sell much cheaper. If the rate at which he borrows be five per cent, he will have to pay £2,000 a year; and if, like the old trader, he make £5,000 a year, he will still, after paying his interest, obtain £3,000 a year, or thirty per cent on his own £10,000. As most merchants are content with much less than thirty per cent, he will be able, if he wishes, to forego some of that profit, lower the price of the commodity, and drive the old-fashioned trader—the man who trades on his own capital—out of the market. In modern English business, owing to the certainty of obtaining loans on discount of bills or otherwise at a moderate rate of interest, there is a steady bounty

**on trading with borrowed capital, and a constant discouragement to confine yourself solely or mainly to your own capital."**

When it is stated (as in the foregoing) that there is "a constant discouragement to confine yourself solely or mainly to your own capital," it is evident that the trend of business is toward a credit basis, for nothing but such a condition would warrant this pronouncement. This condition, which indicates a marked expansion of the credit system, carries with it a danger which must not be lost sight of nor underestimated, viz., many unworthy persons have sought and secured credit to which they were not entitled, and which they have persistently abused. On the other hand, the advantages and blessings of this expansion have been of incalculable value, and have wrought universal good in the opportunities afforded to deserving and competent persons to enter and remain in business life. The economic influence of "our own times" has been to create such opportunities and preserve them to those who are worthy, thus augmenting the general wealth, and adding to the store of personal accomplishment and human happiness.

The example cited by Mr. Bagehot is not an extreme one, but an everyday practice. It must be remembered, however, that the ability to borrow £40,000, as suggested, on a capital of £10,000 is a privilege not given to every man. The one who succeeds in doing it must have the necessary qualifications of character, business reputation, and general ability; otherwise he would not be regarded as a suitable credit risk by the banker or broker from whom he sought the amount mentioned. So that, added to his capital of £10,000, he has his personal qualities upon

which to depend, and they represent a species of wealth when utilized in the quest of credit; or, as Mr. Macleod expresses it:

"A merchant's Wealth, or Purchasing Power, consists of his Money, his Rights to demand Money, i. e., the Bank Notes, Cheques, Bills of Exchange, or other Securities he may possess: and his Credit, i. e., his Right to the future products of his industry."

Out of commercial transactions, or the operation of commercial credit, there arises a mass of instruments of credit which have a function entirely apart from the mere evidencing of a debt due from one person to another. The motive in requiring the tender of a bill of exchange or a promissory note as a precedent to the delivery of a bill of goods is invariably to enable the holder of the bill of exchange to utilize it for his own advantage in creating or maintaining his credit. The consequence is that a bill so used passes from one person to another until it has acted as a medium of help to a large number of people, either in canceling some old indebtedness or in starting a new credit. Mr. Mill says:

"It has become one of the chief functions of bills of exchange to serve as a means by which a debt due from one person can thus be made available for obtaining credit from another."

Mr. Macleod has also explained this phase of commercial credit as follows:

"Suppose that the merchant has confidence in the wholesale dealer's character and integrity, he sells the goods to the wholesale dealer on credit: that is, he sells him the goods, and instead of the actual money, he takes his promise to pay three months after date. That is, he sells the goods for a Credit, or Debt, or a Right of Action instead of for Money."

"Credit in this sense causes the same circulation as money." "Hence Credit is circulating medium exactly as money is."

Attempts to read into the dispensation of commercial credit any hard and fast rule of the "goods to goods" order is a fatuous one in view of the general interpretation of that question, as well as the economic necessities it represents. In England it has not been an unusual thing for bills of exchange which were the outgrowth of commercial credit to form a considerable portion of the circulating medium. This character of currency, which is nothing more than a symbol of credit, has been quite as efficacious in the financial and commercial life of the nation as gold, silver, or bank notes. It is true that a liberal supply of gold in the market assists the use of bills of exchange as circulating medium; for, while the public is entirely satisfied with the state of the gold supply, it is content to utilize other and *cheaper forms* of circulating medium. While this condition exists, the opportunities afforded to extend one's credit through the use of bills of exchange or promissory notes are amplified, and it is then that the temptation to speculate arises, with results which have already been indicated.

To appreciate the great advantage of the credit system, it would be well to consider the effects upon our commercial life if transactions were regulated by the use of cash only, or, to use a favorite business expression, "if we were on a cash basis," the word cash being used in the sense of actual currency.

(1) The relatively small quantity of cash available would prejudice its use in the settlement or adjustment of

commercial transactions, and, in fact, render such transactions, in the gross, impossible.

(2) The cost of its transportation, always a considerable item, would be found onerous.

(3) The loss of interest due to holding large amounts of currency, and the inutility of the commodity itself.

(4) It would be impossible to extend the operations of trade, as modern usage has done, and this modern usage is simply credit. Men would not, in fact they could not, lend their cash to others who desired it for the purposes of capital—no matter how worthy they might be—for the holders would need it for their own requirements. The opportunity for embarking in business, and continuing in it, would be closed to the great mass of those who would otherwise be actively engaged in commercial life. These ideas have been explained at length in the description of the credit system, but recurrence has been made to them here because of their great pertinency to the subject now under discussion.

It was the very fact that commercial credit was not possible if people were supposed to operate on a cash basis that induced the use of credit instruments. The scarcity of the precious metals brought about the use of bank notes (a form of credit), which in some instances represent credit in its unbridled capacity.

Commercial credit merges itself into banking credit by purely natural processes, the former becoming the great feeder to the latter, which in turn assumes the control of the commercial market in a universal sense.

Commercial credit has another well-known form, viz., book credits. Nowadays, in nearly all cases when merchants buy from each other, the only evidences of the sale

expressed are the entry of the charge in the ledger of the seller, and the delivery to and acceptance by the purchaser of an invoice for the amount of the goods sold. When the due date arrives, the purchaser is supposed to send to the seller the amount due (usually tendered in the form of a check on a bank), and the seller enters the evidence of the payment against the account, and the transaction is closed. It will be evident that this character of credit (book) has not performed the same useful function in the commercial or financial world as the credit in consideration of which a bill of exchange or promissory note was passed. In the latter case the seller could avail himself almost immediately of the bill, and with it either pay an outstanding account or bill against himself or use it for the purchase of new supplies or in creating additional necessary credit. It is true that book credits may be used for the purpose of securing funds, and a method which will be referred to at greater length in this chapter is often resorted to. There is one very important respect in which a book credit is not as safe and satisfactory a form of security as a bill of exchange or other credit instruments employed, and that is, that while the holder or owner of a book account or credit may be able to dispose of it, or raise funds upon it, the purchaser or discounter of such an account or credit must necessarily look for its validity in the good character and representations of the one offering the account. It has behind it nothing but the evidence of his books, his statement as to the ownership of it, and the correctness of the amount claimed. People have been known to dispose of accounts that were entirely spurious. In the case of a bill of exchange or promissory note, the evidence of the debt is

verified by the signature of the maker of the paper. Attention has been called to "fictitious" or purely accommodation paper, but the conditions entering into this character of credit instrument do not affect the point under discussion.

Commercial credit exerts a greater influence upon the tendencies of the people than almost any other phase of human activity. This influence manifests itself in the social as well as the economic departments of life. Mr. Aldrich writes:

"Money economy gave liberty, credit gave opportunity. By credit the competitive system has developed so as to be able to replace the primitive group system, and even surpass its accomplishments. Without credit, individuals could not extend their operations so as to supersede the collective system which subsisted as some form of natural or involuntary coöperation until the rise of credit in Europe."

The liberty which was the product of "money economy" would have failed in its beneficent effects upon the masses of the people if credit had not come forward as a powerful auxiliary and made clear the opportunities which the new dispensation had created. One of the principal elements of the "competitive system" is opportunity. The doors of that system are always open "to those who are disposed to hazard their fortunes and future." For many who bid for a place of honor in the competitive system are risking all they possess. Their failure to achieve results means impoverishment and disappointment to such an extent that they never again summon the courage to battle for advancement. The competitive system does not display all its power in the fierce struggles for commercial supremacy in thickly settled and wealthy

communities. It shows some of its best results in the energy with which new localities establish themselves and compete with the older and better known markets. In these new localities the excellent effects of commercial credit are particularly shown. True to the real spirit of commercial advancement, the pioneers of progress seek to open new fields of agricultural and industrial activity. In all new settlements the great want is money, and the only element that prevents such settlements from being utter failures is credit. With any reasonable prospect of success before them, the merchants of a new settlement have little difficulty in securing from those of the older and wealthier communities a fair degree of credit. The credit which they enjoy enables them, in turn, to extend credit to nontraders, who, especially in a new settlement, require this credit in equal measure with those engaged in mercantile pursuits. In new countries or districts there must be a great deal of prospecting, and the inhabitants must avail themselves of credit in the meantime. Without credit it would be impossible to upbuild new territories with the celerity and success that the presence of credit insures. It has been stated that "in colonies and all rude countries there is no large sum of transferable money; there is no fund from which you can borrow." In order, therefore, that those who cast their fortunes in rude countries may possess themselves of the necessary capital, they are compelled to draw upon the funds of long-established localities and nations. The freedom with which they are permitted to do so indicates the state of the credit extended to them. It is very important, however, that they should not be given too much latitude, for this is the cause of booms and speculations;

all of which again enforces the thought that credit to be safe must be restricted within legitimate boundaries.

The methods of commercial credit have undergone many changes, growing out of a greater store of wealth and the expansion of the credit system. The old plan upon which credit was dispensed involved the intermission of a long term before payment would become due, and the necessity of a liberal "time limit" was due to conditions which were, at that period, of an uncontrollable character. Long time was the custom, and unless it could be secured, the merchant was better without the credit. To accept it on any other basis probably meant failure to meet his engagements, with the consequent sacrifice of his business reputation, upon which his capacity to command credit principally depended. There were many excellent reasons why transactions should be based upon extended terms of credit, to some of which reference will be made.

(*a*) The means of communication were in a comparatively archaic state, and it therefore required considerable time to reach the different markets. This great loss of time could not be endured except at certain seasons, when it was absolutely necessary for the merchant to visit the market.

(*b*) The foregoing reason also operated to prevent the general use of traveling salesmen, for the time lost in travel meant that they could not meet a sufficient number of their customers in a given period to make trips pay.

(*c*) The consequence of these conditions was that when the merchant visited the market he bought a large stock, and had to select many goods that would not prove as salable as others.

(*d*) The practice of buying large stocks carried with it the danger of overbuying, and the latter was, under such circumstances, an almost pardonable error. It was a difficult matter to measure the probable sales of a season, especially if the community was a rapidly growing one.

In order, however, that the privilege of the long time and liberal amount of credit accorded to the merchant should not react to the detriment of the wholesaler or jobber, he required that the merchant should give a promissory note at the time of sale, so that he could utilize this note in raising funds with which to operate his own business. To do an extended credit business on long terms involves the use of a large amount of very flexible capital, with which few concerns have been provided at any period of our history.

Notes given by merchants in the manner described have always been considered one of the best forms of bankable paper, and their negotiation into loans was a matter of ordinary financing, and one to which constant resort was made. The existence of this mass of commercial paper (credit) brought into existence a class of men who made it, and who still make it, their special business to market this paper, and who are known as note brokers. The latter represent, however, several different classes, from those who are in reality bankers to those who constitute a middle and very substantial class, who sell to banks and other financial institutions, and, lastly, those who are known, for excellent reasons (which it is not necessary to discuss), as "note shavers." This feature of the credit system made the note broker a necessary and powerful entity in commercial and banking credit. It might be asked why banks themselves could not have per-

formed all the functions of the note broker, and thereby dispense with his services. A few reasons may be given why this was not done: (1) Note brokers made the acceptability of the paper offered a special study, and were therefore better advised as to its character. (2) To do this would have required the exclusive attention of one or more men for every bank, and this in itself would entail a large and disqualifying item of expense. (3) The fact of not being called upon to exercise this supervision meant a saving of energy on the part of the bank's officers which could be utilized to advantage in other directions. (4) Custom warranting a dependence upon the representations of the note broker, the bank was in a position to act quickly in reference to a discount or purchase of a quantity of paper—a very important consideration in case the bank had a large sum of money lying idle which should be earning an income. (5) In certain cases where the bank might not, for excellent reasons, be prepared to accept the single-name paper of merchants, the note broker could, if so disposed, act as an indorser, thus making the offering entirely acceptable to the bank, and it was an advantageous thing to be able to enlist, if necessary, a responsible indorser.

It is pertinent at this time to say that the standing of the merchant continues to determine the rate of interest charged, which is the barometer of the credit of the maker of a note. Modern methods of communication in railway, mail service, telegraph, and telephone have wrought the changes to which reference has been made, and occasioned the disuse of note settlements in the form and to the extent they were formerly employed. The ability to reach the markets quickly, to order goods by

mail, telegraph, and telephone, has enabled the merchant of almost any section of the country to supply his wants as they manifest themselves. This has had the effect of cutting down the time limit, for the conditions previously stated no longer obtain. When to this is added the fact that the banking accommodation is more liberal and ramified than ever before, it is not strange that the merchant should see the advantage of utilizing his credit at the bank, securing the funds which enable him to pay in much quicker time, and obviating the necessity of taking advantage of the long time formerly sought, *and for which he had to pay in advanced price* and interest charges. He now utilizes his bank credit and *discounts* his bills, i. e., he takes advantage of the largest discount offered for a quick settlement.

Prompt settlement (especially of note obligations) is indispensable to the maintenance of good credit. In referring to the desire of merchants to fulfill their contracts in a timely manner, Mr. Bagehot says, "what is necessary to meet their acceptances they will borrow, pay for it what they may—they had better pay any price than permit those acceptances to be dishonored." It is a fact that the failure to meet a note promptly is counted as a black mark against a merchant, while in the case of a book credit, a delay to pay promptly (three or four days and more, sometimes) causes no particular unrest. This difference it is hard to satisfactorily explain, but probably consists in the more exacting nature of a written as against an unwritten agreement.

The discontinuance of "long time," such as four, six, and eight months, has had the effect of introducing the feature of "dating" into commercial transactions and

credit. A "dating" of thirty days or sixty days indicates that the term of the credit, whatever it may be, does not begin to date until the expiration of the term of dating. For instance, a bill sold and charged on January 1, 1906, with a dating of sixty days—terms, two per cent ten days and net thirty days—is not due until April 1st, as the dating does not expire until March 1st, and the terms being thirty days carry it to April 1st. The purchaser has the option of paying it whenever he chooses, but payment cannot be insisted upon until April 1st. A merchant purchasing a bill under the foregoing terms would, if he were in a position to do so, pay the bill at the end of ten days (January 10th), deduct two-per-cent discount, and also deduct interest at the rate of six per cent per annum for the unexpired term of sixty days (the dating), of which time he has not availed himself. With the general shortening of terms, dating was given to cover the period during which the goods would be in transit, or in process of unpacking and marking. It was also used as an inducement to merchants to make purchases before the seasons opened, or in other words to anticipate their wants. From a concession on the part of the wholesaler and jobber, the idea of dating seems to have become a *right* demanded by the merchant, and a settled principle in commercial practice or credit. It has led to an undue anticipation of wants on the part of those engaged in all divisions of trade, from the manufacturer to the retailer; and in lines where the element of fashion is a leading one, and subject to sudden changes, it has been the cause of considerable loss to many.

Reference has been made to a method by which "book credits" are utilized for the purpose of raising funds and

supplying needed capital. It is probable that this method found its inception in a practice introduced some years ago, whereby a house having no other form of collateral to offer its bank, and being much in need of money, induced its bank to accept an assignment of certain accounts. Advances were made by the bank to an agreed percentage of the gross amount of the accounts assigned. This was an entirely private arrangement between the bank and its customer. When the bank had confidence in the integrity of the assignor and in the prospects of the business, it would permit the assignor to use the funds collected from the accounts assigned, and in place of these collected accounts, other and supposedly desirable accounts were assigned to the bank, thus preserving the required ratio of margin. It will be evident that a bank lending under such conditions must have a good deal of confidence in the character and good intentions of the borrower, for an unscrupulous person could deceive and defraud his banker. In the event of the failure of the borrower, or of any suspense in the relations between the bank and him, the bank would naturally enter upon the exercise of its rights under the assignment, and the persons owing the accounts which had been assigned would be notified to make payment to the bank. In some instances the notice of the assignment would be sent at the time of its execution, and the debtors called upon to make payment to the bank. This method is resorted to by commission houses which are handling the output of manufacturers to whom advances have to be made, and has contributed to establishing a new method of invoking commercial credit. The consequence is that banking houses have opened regular departments for this character of business, and many lead-

ing commission concerns have practically become bankers, to such an extent are they advancing upon and discounting accounts. There are concerns which make this their sole business, and some are reported to be doing a large volume of business. Such concerns have behind them banks or trust companies which furnish the funds to purchase or discount accounts, and find in this a very lucrative method of lending money. The terms under which this business is done vary. In some cases the accounts are assigned only in the manner already discussed, and a margin preserved, the borrower being charged a good rate of interest for the accommodation. In others the accounts are bought outright, the purchaser assuming all the risk, and charging not only a round rate of interest, but a bonus for the risk involved. In still others the accounts are assigned, and withdrawals permitted to an agreed percentage (seventy, eighty, or ninety per cent, as the case may be), and a heavy rate of interest, as well as a bonus, charged for the accommodation. If the percentage of profit obtainable in the business will justify the payment of the high rate of interest and bonus demanded, it may not be in order to criticise this method of commercial credit. It has yet to be determined how successful for all parties concerned the practice involved is likely to prove. This fact should be borne in mind, that whenever a house is paying an extravagant rate of interest for the accommodation it requires, the difference between normal and abnormal interest is the difference between normal and abnormal credit, and the strain upon the credit of an enterprise is bound to leave undesirable effects. The same general rules should apply to all the divisions of credit. The same monitors should stand guard over

the respective members of the great credit family. These rules and monitors are the same in banking, capital, public, individual, and commercial credit—their names are integrity (character), ability, prudence, economy, and conservatism.

# PART THREE

# THE CREDIT DEPARTMENT AND SOURCES OF CREDIT INFORMATION

# CHAPTER VIII

## THE CREDIT DEPARTMENT IN BANKING CREDIT

SYSTEM in credits is exemplified in the methods of credit departments. A credit department is now regarded as an essential adjunct to every well-regulated business. The banking community, however, has not recognized the necessity of a distinct credit department in the same sense as have commercial institutions.

Not many years ago there were comparatively few banks possessing a credit department; to-day there are more, but there is still an unexplainable absence of this systematic method of treating credit transactions. Attempts are made to answer this criticism by saying that a credit department is unnecessary, for the reason that the duties appertaining to it in a commercial establishment are discharged by certain officers or employees of a bank in connection with their other work; consequently, no necessity exists for an elaborate equipment or system covering the relations of a bank with its borrowers, and a complete tabulation of the standing, antecedents, and responsibility of such borrowers.

The real objection of banks to a credit department heretofore, and to some extent even in this day, may be found in the fact that it has always been customary for banking officials to possess great power—in fact, an arbitrary

power—in the matter of loans and other banking business. All important questions are supposed to be passed upon by boards of directors, but it is well known that in many institutions, both in large centers and in rural communities, the *ipse dixit* of the president or cashier (whichever may be the dominant official of the bank) has been the determining voice in most important matters. These officials, therefore, have not only been possessed of the power to which reference is made, but they have carried within their own minds the data in regard to loans and the general relations of the customers with the bank. The possession of this information has made them even more powerful than they otherwise would have been, and made their continued association with the bank in some cases imperative.

In the measure that a bank's investments are sound will be determined the profits or dividends of the bank to its stockholders and the general prosperity of the institution. The small percentage of profit pertaining to banking transactions makes the responsibility that rests upon a bank's officers a delicate and onerous one. Unwise credits (unwise loans) reflect a degree of loss upon the bank in the same sense that actual peculation does, and proper means should be devised for the correct guidance of the officials of the bank in determining to whom its funds should be lent. A failure to observe the duty imposed upon the officials of a bank in this respect is an absolute breach of the faith that is reposed in them by the stockholders and depositors of the bank. This faith consists not alone in confidence in their honesty in the handling of funds, but in their ability to so manipulate them that only a minimum of loss will result.

Many large banks act as an investing medium for their correspondent country banks. The latter are, in many cases, large purchasers of commercial paper, and make their purchases mainly upon the representations of the bank with whom they are doing business. How can they be properly advised as to the desirability of the paper they intend to purchase unless the inquiries into the standing and responsibility of the makers and indorsers of that paper be of the most rigid character? Is it reasonable to suppose that an officer of the advising bank, if he be depending solely upon his personal impressions, or information that he is carrying in his mind (a mind overcharged in these busy days with other details and matters), can give as wholesome advice to those who are seeking it as if he had before him thoroughly prepared and extensive reports drawn from reliable and useful channels of information? It is freely conceded that no amount of system and no amount of investigation will act as a complete bar to losses. There is no question, however, that in these days of widely diversified interests, the more thorough and perfect the system the less liability there will be to losses and misadventures.

A credit department should represent the simplest and most effective methods for acquiring information, all reasonable utilities for making the range of information as broad as possible, the compilation in presentable form of the information gathered, an entry into the records of that department of every iota of information it is possible to glean, *and also a citation of such personal impressions as the officials of the bank may from time to time entertain in regard to the desirability of an account.* An incident may occur in the relations of a bank with a borrower

to which no importance may be ascribed at the time, but if promptly noted upon the records of the credit department may in after years, if considered in connection with some new development, have a very decided bearing upon the judgment which the officer will then form as to the standing of an applicant for credit.

The title "credit man" is applied to him who is in charge of a credit department. There have been many word pictures painted of this individual; the disposition has generally been to idealize him—a not uncommendable motive, but one which should not be tortured into imposing upon the credit man the possession of too many virtues or an extravagant order of abilities. The best credit man is the practical man; the man of sufficient general knowledge to be able to quickly appreciate the cogency of any statement or situation that may be presented to him; a man of executive capacity; a man who understands the necessity of and does not shrink from hard work; a man with sympathy for his fellow beings, but not of so impressionable a nature as to permit his sympathies to unduly influence his reason. In addition to a knowledge of commercial affairs and methods, it is desirable that the credit man of a bank should be one who is familiar with the different departments of banking business.

The most practical manner in which to study the operations of a credit department in a bank is to follow the treatment and course of an account through its different stages. The system necessary to such a department involves the use of forms without which it would be impossible to correctly carry into effect the theory of this branch of the bank's work. In the present discussion the use of

these forms will aid in the illustration of many questions which must be referred to.

It is assumed that a person presents himself at a bank and expresses a desire to open an account and maintain regular relations with it as a depositor and borrower. The officer of the bank who interviews him, in order to secure an orderly statement of certain essential information, uses a form (Form 1) upon which he notes the answers to the questions.

This form is entitled "Account Opened," and marks the foundation of the data which goes into the records of the credit department. The first line contains spaces in which the fact of the account being opened is noted by the different departments. The other items on the form are all of a basic nature, involving nothing of a technical character. When this form is being used by the bank officer in the presence of the person who is opening the account, it is folded inward at the last line extending across the page. The reason is that the printed matter below refers entirely to questions which the bank does not deem it necessary to display before the customer. The latter must be aware, if he be a well-informed person, that sooner or later he will be asked for a statement of his affairs, that letters of inquiry will be issued regarding him, and that reports will be asked from the agencies in order to ascertain what his standing may be. It is presumed that the account is to be a continuous and active one. The bank should secure, as early as possible, a thorough statement from the customer, showing all essential details of his business, that there may be such knowledge in hand regarding him as will enable the bank to deal justly with him as well as with its own interests. A

NOTED: Credit Dept.__________Spl. Cor. Dept.__________Cor. Dept.__________

FORM TO BE FILLED OUT WHEN ACCOUNT IS OPENED

Title____________________ __________190___

Business________________Address________________

Character of Acc't: Personal or business______Borrowing______________

Probable balances carried, $________Other Bank acc'ts______________

Reason for changing ____________________________

Introduced by____________________________

References____________________________

____________________________________

Account accepted by______________Signatures taken by______________

Remarks____________________________

____________________________________

____________________________________

Statements__________Letters of inquiry__________Reports $\left\{\begin{array}{l}\text{Dun\_\_\_\_\_\_\_\_\_\_} \\ \text{Bradstreet\_\_\_\_\_\_\_\_\_\_} \\ \text{R. D. P. A.\_\_\_\_\_\_\_\_\_\_}\end{array}\right.$

FORM 1.—FORM USED WHEN AN ACCOUNT IS BEING OPENED.

man's first offering of collateral may be an excellent one, precluding (some may imagine) the necessity of anything more than the most general knowledge of his standing. The next time he asks permission to borrow he may not be able to furnish as favorable security, yet expects, as many do, and succeed in doing, to trade upon the good impressions created by his first borrowing transaction. The effective way to guard against the subtle influences of these *impressions* is to have a thorough understanding in the very beginning, and secure at that time the information which will guide aright at any stage of the account. Some banks ask for a statement of affairs before accepting an account. It is entirely proper to do this, for it is not to the credit of any bank to have undesirable names upon its books. The avidity with which accounts are sought and accepted in these days need not be regarded as impairing the practical soundness of this opinion.

The policy of asking for and insisting upon statements being furnished is only of comparatively recent origin. Some banks have followed such a policy for many years but it was not until the American Bankers' Association and the associations of State bankers gave to the subject their indorsement, and many of the State organizations adopted forms of statements, that individual banks would admit the wisdom of such a policy. It is a fact that banks have in the past refrained from asking their customers for statements, hoping to create in the minds of those customers the impression that this particular bank was a very liberal one, and did not intend to fetter itself or bother its customers with technicalities. It will be asked how such a bank could properly fortify itself with information upon which to make its loans. It would se-

cure such information as it could, in the shape of written references and agency reports, depending upon the statement given by the customer to the agencies. This statement was in *most cases months old*, and also, in *most cases*, unsigned, so that it will be evident that a bank conducting its credit business in this manner was standing upon unsafe ground. At one period of our commercial and banking history many traders regarded it as an unwarrantable infringement of their private rights to be asked to make out a statement on the forms prescribed by banks and business houses, but numerous causes have contributed to dissipate this feeling.

In an address on "Business Education and Commercial Banking Methods," by Mr. Henry Clews, of New York, read before the Sixteenth Annual Convention of the Minnesota Bankers' Association (June 20–21, 1905), he says:

"The man who would get credit must fill out forms which furnish in more or less detail, according to the circumstances, the data which will enable the bank to judge of his business. In the modern financial institution the 'credit department' has become the regulator of the whole mechanism. Some consider the present requirements of full statements and appraisement unreasonable. There has probably never been a change or forward step in business practice that was not so considered by some of the persons affected by it. Yet no change in our banking methods can be more conspicuously justified than this. It has long been in vogue in foreign countries where banking is more nearly a profession than a business."

The bank asks the customer for a statement of his affairs, and furnishes a form (Form 2) for him to fill out and sign.

It being assumed that the relations upon which the customer is entering with the bank are to be of long duration (at least that is the business supposition in reference to most accounts), the bank is justified in asking at the outset for all the information it believes it should possess. A statement such as that submitted in Form 2 would have been regarded some thirty years ago as calling for details that were essentially the private affairs of the customer, and into which no one had the right to inquire. The questions set forth in this statement, however, cover such facts as it is necessary the bank should examine into, and an omission so to do is attributable to poor business methods.

Notes receivable and accounts receivable are only to be enumerated so far as they are in the actual possession and are the property of the person making the statement. This qualification is necessary, for there are people who, even after they have transferred notes receivable or accounts receivable as collateral, believe that these notes and accounts are still their exclusive property, and in estimating their worth are at perfect liberty to compute these items as full assets.

The item of merchandise is also divided into three classes—"finished," "unfinished," and "raw material"—and the means employed for determining its value must be stated. It is essential that this differentiation should be made, as the relative amounts of the respective classes of merchandise may have a vital bearing upon the general results of a statement. A concern with a large amount of unmarketable raw material on hand may, because of this fact, be at a considerable disadvantage. Unless, therefore, the different classes of merchandise are explained in

detail, the credit man might, and probably would, contract an erroneous opinion as to the value of the merchandise held. It is required in this statement that it be specified whether the items of land, buildings, and machinery are owned by the firm and used for the business. This is a wise provision, for very often people will list property, in which they may have a party or family interest, in a statement of their firm's assets.

In the liabilities column there are three classes of notes payable—those "given for merchandise," "negotiated to banks," or "otherwise disposed of." A division of this character, instead of a single entry of notes payable, enables the credit man to get a much clearer idea as to the nature of a firm's liabilities and also its credit standing in financial and commercial circles. This subdivision also assists in determining whether a firm is unduly "spreading" its credit.

In the list of general questions, that of insurance occupies a prominent place. In every large business in these days, insurance to an adequate extent is usually carried. With small concerns this is not the case. It would be well if, in dealing with small firms or corporations, bankers would insist upon the question of insurance being fully respected.

The items of "business and results," "annual sales," "gross profits on sales," "expense of conducting business," "net profit," "other income," and "combined profit" are all of the most important character, and the entries shown against these items will indicate in a special way the exact trend of the business—whether toward progress or whether it be losing ground.

Withdrawals by partners is a matter that should be

carefully studied in analyzing a statement. The withdrawals will indicate whether the partners are living within the means of the business or whether they are going beyond what is reasonable for their individual purposes.

It is necessary, in examining a statement, especially one made by a concern that does a large credit business, to understand exactly what its loss through bad debts has been for a stated period. This will show whether the firm be careful or imprudent in the extension of its credits; if the latter, it is an undoubted danger signal, and failure to respect it will result in trouble, both for the concern itself and those who do business with it, whether in the form of financial or merchandise accommodation.

It is also advisable that a bank should know with what other banks its customers are doing business. It might develop that a house was carrying a large indebtedness with several different banks and securing accommodation beyond its deserts. An investigation of its accounts with other banks will reveal the safety or unreliability of the account, and such investigations are the outgrowth of the questions asked as in statement form, Form 2. Thorough attention to this character of investigation will in the end result in minimizing to a very great extent the losses incurred by banks.

The terms on which the bank's customer sells his goods, the terms on which he buys, the time of year when his receivables are maximum and minimum, when his merchandise is maximum and minimum, and liabilities are maximum and minimum, all indicate at what periods the concern will be most likely to require help from its banks.

Knowledge on these points will enable the bank to decide as to the propriety of an application for a loan. As an example: if a customer were to ask for a large loan at a time of the year when, according to his own admission in a statement which he had given the bank, his ready resources should be the largest, it would indicate a condition requiring prompt attention on the part of the bank if he were already a creditor; or otherwise, as to the wisdom of making the loan requested.

The last question on this statement to which reference will be made has only recently come to be regarded as a living issue in credit economy, viz., verification as to whether the books have been audited by a certified public accountant. The failure to have a concern's books examined at stated periods has frequently permitted the growth of unwise practices. The fact of no examination of the books being made by an outside and thoroughly impartial person has left them absolutely under the control of those who may be either not entirely competent or inclined to dishonesty. It is a matter of frequent occurrence that a firm will discover after many years that a trusted employee has been defrauding it through peculation. The latter condition would undoubtedly have been revealed if the books had been examined at regular intervals by competent accountants. It is a healthy sign that banks have determined to ask and insist upon such examinations. This policy will have the effect of eradicating irregular methods and greater evils. Another beneficial effect will be the education of the business public as to the necessity for these examinations, which should be a matter of frequent and orderly procedure.

As a specimen of a simpler form of statement than

that just described, references should be made to Form 3.

The foregoing statement forms are those for use by firms. The corporation has become a commercial entity, and forms adaptable to corporation organization and mechanism also have to be used. Different types of these forms are shown in Forms 4 and 5.

Considerable credit information is obtained by banks through means of correspondence. The very nature of a bank's business and its standing in the community enable it to request such information with the assurance that it will receive prompt, courteous, and thorough attention. With this in view letters, very often of a general character, unless there be some special question it is necessary to ask, are addressed to business houses, and also to banks. A type of letter which is used for securing information from business houses is here given (Form 6), and another type used for correspondence with banks is shown in Form 7.

These letters do not call for any extended analysis or criticism, as they are simply statements of what is desired.

Banking credit departments also avail themselves of other well-known opportunities for acquiring credit information, but as the latter will be made the subject of a special study as this work proceeds, it is not necessary to make further reference to them at this time.

Having secured such information as it was possible to obtain, the credit department must express its opinion as to the propriety of making the loan applied for. While only one character of loan has so far been referred to, the same methods of investigation would be applied to any other class of loan, whether one represented by single-

name paper without collateral or paper carrying an indorser or indorsers and with or without collateral. There are certain loans, particularly call loans, which are covered by what is supposed to be the liveliest kind of collateral. These are sometimes handled in a loan department, and do not come before the credit department, the reason being that loans of this character are covered by collateral of such well-known market value that the loan is made really upon the collateral, with little respect to the person or persons making the note.

The businesslike character of a statement of a person's affairs when placed in the hands of the credit man or a bank official cannot fail to make a favorable impression upon him. A statement prepared with a great deal of care and in which every effort seems to have been made to answer all questions fully, will create a better impression than one prepared in a slovenly manner, particularly where any disposition, even the slightest, has been shown to withhold information. It has been remarked on this point that

> "Failure or inability to make out a statement form correctly indicates poor business capacity or careless methods of bookkeeping."

Writers on banking credits agree that the character and ability of the person or persons making the statement, or the character and ability of those who are directing the organization, as of a corporation, have a vital and, some hold, a determining influence upon the acceptability of an account for loan purposes. It is intended to discuss these characteristics in detail as we proceed.

It is a matter of general supposition that people doing

| | NAME IN FULL | ADDRESS |
|---|---|---|
| President | | |
| Vice-President | | |
| Secretary | | |
| Treasurer | | |

## DIRECTORS

| NAME IN FULL | ADDRESS |
|---|---|
| | |
| | |
| | |
| | |
| | |
| | |

[Please sign here]____________________

By____________________

Date signed____________________ 190___

We are seeking as close information as possible relative to the character, credit standing, and financial responsibility of

and presuming that you are in a position to advise us as to the manner in which they meet their business engagements,—whether they avail themselves of the best discounts offered, etc.—we write to ask if you will have the kindness to render us such service in the premises as may be within your reach. We shall appreciate any details you may be able to give us, respecting their affairs and methods, that will be of value in guiding us to a correct conclusion as to their desirability as a credit risk.

Tendering you our best thanks in advance for your courtesy, and assuring you that whatever you may say to us in this connection will be treated as confidential, we are,

Very respectfully yours,

FORM 6.—GENERAL FORM OF INQUIRY LETTER.

We are desirous of securing as close information as possible relative to the character, credit standing, and financial responsibility of

and understanding that they have an account with you, we beg to ask if their business is handled in a correct and satisfactory manner. Is your confidence in them such that you are willing to extend them a liberal line of accommodation? We shall appreciate any information you may be able to give us that will prove of assistance in guiding us to a correct conclusion as to their desirability as a credit risk.

Tendering you our best thanks in advance for the courtesy of a reply at your convenience, and assuring you that we shall be only too happy to reciprocate in a similar way at any time, we are,

Very respectfully yours,

FORM 7.—GENERAL FORM OF INQUIRY LETTER ADDRESSED TO BANKS.

In consideration of the making, at the request of the undersigned, of the loan evidenced by the within note upon the terms thereof, and of the sum of one dollar, the undersigned hereby guarantee to THE FOURTH NATIONAL BANK OF THE CITY OF NEW YORK, its successors, indorsees or assigns, the prompt payment of the said loan when due, and hereby consent that the securities for the said loan may be exchanged or surrendered from time to time, or the time of payment of the said loan or of any of the securities therefor extended, without notice to or further assent from the undersigned, and that the undersigned will remain bound upon this guarantee notwithstanding such changes, surrender or extension. The undersigned waive demand of payment from the maker of said note, and also waive notice of non-payment of the said loan or note, and also waive notice of any sale of the collateral securities held for the said note.

business with banks are entitled to a certain defined limit of accommodation based upon their average balances; and that failure to accord them such accommodation arises from lack of friendship on the part of the bank or a system of favoritism toward other customers which prejudices the bank's ability to lend its money among all its customers in ratable proportion. Opinions expressed by bank officials on this point are on the order of the following:

> "Bank credits should be granted to the customers of a bank according to their balances and responsibility."
>
> "The value of a bank account is largely determined by the net average balance which it carries."
>
> "The average balance should be a determining factor as to credit extended."

The foregoing are in accordance with what would be regarded as a safe and just policy for a bank to pursue toward its customers, and undoubtedly these are the ideas upon which most bank officials believe that loans should be regulated. It is evident that this policy is respected as much in the breach as in the observance. In an investigation made by an officer of a prominent New York bank some years ago as to the plan or basis upon which discount lines were determined, it developed that there was no uniform system, the larger number of banks reporting that they had no definite method for basing discount lines as proportioned to balances. Some men manage, by what exact means it is impossible to determine, to ingratiate themselves into the favor of banks and secure accommodation entirely out of proportion to their responsibility. It is not necessary to quote any living

examples of this practice. The liabilities due to banks in failures occurring daily, prove the absolute verity of the statement. This condition should be the subject of corrective measures. Where favoritism is shown

We are making the customary revision of our files on

and would appreciate your present opinion of their financial responsibility, management, etc. Has there been any change in your estimate of their credit standing since your former letter to us, dated,

Thanking you in advance for a reply at your convenience, and assuring you of our desire to render you reciprocal services, we are,

Very respectfully yours,

FORM 9.—FORM OF LETTER USED BY BANKS WHEN MAKING REVISIONS OF CREDIT INFORMATION.

in the dispensation of bank credits, it is invariably a deserving element of the public that is discriminated against.

When it is determined to make a loan on collateral, it is usually desired that the customer shall use one of the bank's forms of notes in executing the evidence of indebtedness about to be contracted. The general form of these notes is as shown in Form 8.

These notes are of different forms, time or demand. The body of the notes must be drawn with a great deal of care in order that the interests of the bank in making the loan may be fully safeguarded and that its right to demand additional margin and proceed to recover under the note and dispose of the collateral deposited on account of the loan will be entirely clear and in accordance with the statutes of each particular State.

The work of a credit department carries with it the responsibility of making revisions of the bank's credit reports at stated periods. The great advantage of these revisions lies in the fact that the credit department making them is enabled to keep abreast of any changes which may develop in a concern's standing, and when a question arises in regard to an account, the information is in hand, and it is not necessary to delay matters while a new investigation is entered upon. In Form 9 is given a form of letter employed when making revisions of reports, which sets forth briefly the idea that it is for purposes of revision that the information is being requested. It also calls attention to the last report issued by the correspondent, thus suggesting a checking of his own files, and prompting him to give the account such notice as might not otherwise be extended to it.

Banking credit departments, as also credit departments of large business establishments, make it a practice to request from those with whom they are doing an active business a statement of the concern's affairs at least once a year, and, if necessity should arise, a statement showing the results of the business every six months. In order that the gist of these statements may be kept before the credit man in epitomized form, it is customary to include among the records of each person a comparative statement, as shown in Form 10.

The figures appearing in this comparative statement, or "comparison of statements," are transcribed from the original statements by a clerk in the credit department. The questions entered in the comparative statement constitute the essential items of a statement form. It will be observed that the comparative-statement form is so arranged that there may be entered upon it the figures covering the standing of a concern as shown in its statements for a number of years. There may be as many columns (indicating years) as the person using the form chooses to employ. The figures entered are subject to ready consideration, and will show, as the eye glances across the page, whether the firm has been making or losing money. Comparative-statement forms are also used for corporations, the only changes necessary being to include questions that do not affect copartnerships, but enter into corporate organization.

The customers of a bank consist of those in commercial, professional, and private life, and banks as well.

"The same reasons which make it desirable for a private person to keep a banker, make it also desirable for every banker, as respects his reserve, to bank with another banker, if he safely

can. The custody of very large sums in solid cash entails much care, and some cost; everyone wishes to shift these upon others if he can do so without suffering."

There are times when banks must secure loans in the same sense as others find it necessary to do so, and in extending accommodation a bank's standing and responsibility must be considered just as rigorously as the application for accommodation from a private person. Statements from such banks are insisted upon, and general investigations are also made where banks may be acting as a collecting medium. A form of statement so used is shown in Form 11.

The items of this statement vary from the items shown on a statement which has to be given by a commercial house, as the general character of banking business differs from commercial business. The principles involved in the statements are exactly the same, the purpose being to secure complete data affecting every branch of a bank's business. In Form 12 will be found a form of statement for banks which is also used, and it will be noticed that it is an abbreviation of the form shown in Form 11.

The difference in these two forms of statement illustrates the difference in the methods of certain institutions. In some the policy is to exact all the information that from the most technical standpoint would be demanded, while in others the desire seems to be to simply secure information regarding the most important features of a bank's assets and liabilities. When a bank desires to secure a loan, it submits as security for such loan a list of notes it holds made by its customers, which list is copied upon a form (Form 13).

This form is a very simple one. It contains the name of the proposed borrower and the address; in the column "Makers and Indorsers," the names of the people appearing upon the notes to be furnished as collateral, their addresses, the due dates of the notes, and the amounts of them. On the left-hand margin there is a very important column; in it the clerks in the credit department enter the ratings (from the Mercantile Agency records) of the people whose notes are offered as collateral; a glance at these ratings will satisfy the credit man as to the approximate standing of these persons, the desirability of the collateral, and the class of traders with whom the bank's customer is doing business. In the chapter on commercial credit the nature of such collateral and its relative acceptability were discussed at length, and it is unnecessary to repeat the very favorable opinion expressed in regard to such bankable paper.

Revision of the information regarding banks is necessarily resorted to, and a form of letter used is shown in Form 14.

Comparative statements are also utilized in compiling information in regard to banks, the ideas involved being those explained in the comparative statement already described.

It develops from time to time that where a concern may be carrying a loan with its bank, it will find it necessary to ask for further accommodation. In order that the official who will pass upon the application may have before him the facts in regard to the standing of the account, a form such as shown in Form 15 (or others very similar thereto) is used.

# BILLS RECEIVABLE

OF

| Rating | Makers and Indorsers | Location | Due Date | Amount |
|---|---|---|---|---|
| | | | | |

Form 13.—Form used by a banking credit department for listing bills receivable offered as collateral.

In making the customary revision of the information on our files relative to the banks to which we send our collections, we have observed that your institution is reported as having the account of the

and we are, therefore, prompted to ask if you will kindly favor us with your opinion of the standing, condition, and management of the bank in question, as well as furnish us with such details as may be consistent, touching their desirability and safety as collection agents.

Assuring you that whatever you may say to us in relation to the institution inquired about will be treated as confidential and that we shall be happy to render you a reciprocal service whenever it may be your pleasure to call upon us, we are,

Very respectfully yours,

FORM 14.—FORM OF LETTER USED WHEN REVISING CREDIT INFORMATION IN REGARD TO BANKS.

Offered by ____________________

Date ____________________

| | SINGLE | BILLS REC. | COLLAT. | | |
|---|---|---|---|---|---|
| Under Discount | | | | Gross Profit Last Six Months | |
| Purchased | | | | Av'ge Balance " " | |
| Loan Department | | | | Present Balance | |
| | | | | Amount of Offering | |
| | | | | Time " | |
| Total now held | | | | Total, if accepted | |
| Due | | | | | |

| RESOLUTION | LAST STATEMENT | LETTERS OF INQUIRY | REPORTS | APPROVED | DISAPPROVED |
|---|---|---|---|---|---|
| | | | | | |

FORM 15.—FORM USED IN A BANK TO SHOW THE GENERAL STATE OF A BORROWER'S ACCOUNT WHEN A LOAN IS UNDER CONSIDERATION.

This form sets forth the name of the applicant, the date, the amounts of any loans that may be in the bank at the time and their nature, and the total so held. It is necessary that not only the responsibility of a person should be of a satisfactory character, but it is also important that the account kept by him in the bank be a profitable one; if the showing of the latter be in his favor, the probability of his new application being granted will be augmented. There is set forth in the form the gross profits of the

account for the preceding six months, the average balance during that period, the present balance, the amount of the latest offering, the time it is desired to run, and the total amount that would be owing if the new offering be accepted. There are also spaces in this form for entries indicating that resolutions have been adopted authorizing the borrower to contract with the bank for the loan, the date of the last statement in hand, information as to letters of inquiry that have been received, also as to reports secured, and notations as to whether the application is approved or disapproved by the authorities of the institution.

In a credit department in a bank there is often employed a card-index system, which serves two purposes, as shown, for example, in Form 16, as given on the page opposite.

The first purpose is the preservation of an accurate list of the bank's customers and others, and the second a notation yearly, in the spaces indicated, of the ratings of Messrs. R. G. Dun & Co. and the Bradstreet Agency, the two universally recognized standards of mercantile-agency service.

While the institution of the credit department in banking business has been a matter of slow and unsteady growth, it has received during the past few years the sponsorship of many prominent and powerful banks, thus giving it a permanence in banking economy. This is strongly evidenced by the great broadening process that has developed in the work of credit departments in certain banks. One notable departure in the management of credits is worthy of mention. Professions, trades, and callings have been assembled and classified; each classifi-

| 1900 | 1901 | 1902 | 1903 | 1904 |
|---|---|---|---|---|
| | | | | |
| **1905** | **1906** | **1907** | **1908** | **1909** |
| | | | | |

Form 16.—Index card showing the name of a customer or correspondent of a bank, and also mercantile agency ratings.

# CHAPTER IX

## SOURCES OF CREDIT INFORMATION

### (A) *Salesmen's, Attorneys', and Bank Reports*

THE outline of the work of a credit department in the banking business will indicate the scope of credit-giving both in banking and in commercial affairs. Such work involves responsibilities of a grave and burdensome character. Every credit means a risk; the circumstances that enter into the credit are attended with the element of risk, and the safest credit is that in which the hazard is minimized to the smallest possible degree. The risk involved will be determined by the sufficiency and accuracy of the information gathered. It follows that the dispensation of credit is affected by two leading considerations: first, the character of information secured; and second, the wisdom shown in deciding whether the risk should be accepted or declined. The credit man is a lay judge; he has to pass upon the financial and personal acceptability of the people who seek business accommodations. He is required to study the evidence submitted to him; to consider that which is material, and discard that which is irrelevant. After he may have decided that the case is one of merit, he must go further and determine to what extent he is justified in granting credit.

The means of acquiring credit information are almost

entirely the outgrowth of the systems suggested and put into practice by those engaged in commercial credit. The fact that the systemization of credit-giving was undertaken by commercial houses at an earlier period than by banks accounts for this condition. To a great extent the same methods must be utilized by banks and commercial houses. The fact that the larger volume of credit information arises from the necessities of commercial intercourse justifies confining this description of the methods employed in securing credit information to those followed in commercial credit. One writer says:

> "The relative credit of different merchants is a great tradition, a large mass of most valuable knowledge which has never been described in books and is probably incapable of being so described."

It would be an impossibility to attempt a description of the relative credit of merchants. The nearest approach to such an attempt is the work of the mercantile agencies in the rating books published by them, and as will be seen when this branch of the subject of credit information is discussed, the large number of changes developing every year renders these books approximate guides only of the reputed standing of the merchant. The changes occurring daily in the financial status of merchants makes credit-giving an extremely delicate task; this changing character necessitates constant vigilance on the part of those charged with the dispensation of credit, in order that too much dependence may not be placed upon old information when the acceptability of an account is being considered.

A credit man who conducts a well-regulated credit office will not be satisfied with merely drawing from one or two sources of information, but will tap every spring

whence he has reason to believe there may flow such data as will be of use to him in deciding as to the merits or demerits of an account. Some credit men act upon the theory that if they obtain reports from two or three sources and find nothing derogatory in them, they are entirely safe in deciding that credit should be extended; on the other hand, if they were to have a definite policy as to employing information from every reliable known source from which credit information is obtained, and adhere to the policy of consulting such sources, the danger of making mistakes would be largely avoided. It will be contended that the employment of many different sources of information involves a great deal of labor, the loss of time, and unnecessary expense, but this is not a reasonable objection, for unless this character of work be done, the credit man has failed to meet the necessities of his position.

The general principles of credit, viz., confidence, trust, faith, good opinion, business reputation, borrowing capacity, and the time required (the element of futurity) apply with equal force to all branches of credit. If the application of these principles to each particular case be studied by the credit man, and considered as guides in arriving at his decision, he will avoid many mistakes. The prominence of the element of risk in credit work prevents the adoption of what might be called hard and fast rules.

In seeking information, preparatory to opening an account, it is important to take note of every class of views it is possible to obtain. It is often supposed that when houses express an unfriendly opinion of a man who is seeking credit they may be doing so to prevent his open-

ing new lines of credit, or because of some petty dispute they have had with him, in which he may have been entirely right and they altogether wrong. In order to provide against overlooking this class of information, investigations should be as diversified as possible.

## CREDIT INFORMATION OBTAINED THROUGH SALESMEN

One of the oldest sources of credit information consists of the advices and general reports made by salesmen to the credit departments of their houses in regard to people from whom they accept new orders and also those who may have been customers for a long period. The idea of utilizing a salesman's abilities and time for this purpose is a natural one, especially in reference to people who are not in the habit of visiting the market, and who, therefore, are known only by name and reputation to the firms from whom they purchase goods. The salesman is the only representative of the selling house the customer has ever met. He does not know the principals of the firms from which he purchases, and he has never met the credit man or the person who passes upon his desirability as a customer. The general nature of the salesman's duties imposes upon him the necessity of being friendly with customers, and he is anxious that this friendship should be reciprocated in order that his ability to sell goods may be helped by the esteem in which the customer may hold him. He has opportunities, therefore, of asking questions that do not come within the province of even the credit man, for the latter, if unable to meet the customer, must depend upon correspondence to draw forth such information as he may desire. It would seem almost

unnecessary to call attention to the palpable fact that correspondence, no matter how diplomatic, will not produce the same excellent effects upon the customer's mind as will follow an oral interview, assuming that the latter is conducted with evidences of friendly regard and dignity.

Proper consideration of the place the salesman should occupy in business economy is a subject to which sufficient attention has not been given in the past. No element of business requires a higher order of intelligence than that of salesmanship, and where a combination of intelligence and good education is found the results will be correspondingly greater. A good salesman is essentially a student of markets. He can only bring to the study of economic conditions that refinement of judgment which the subject requires when he has at least a rudimentary knowledge of the facts of commerce and a mind trained to apply those facts of commerce to everyday questions. As the friend and in many cases the business adviser of his customer, he has opportunities for observing the habits, the temperament, and the environments of the man in trade, and these opportunities and the knowledge acquired through them should make him a useful ally of the credit man.

In order to have the information obtained through salesmen submitted in systematic form it is customary to use blanks upon which the salesman is supposed to submit his reports. In Form 17 is presented a blank for this purpose which is a form published with the approval of the National Association of Credit Men, the adoption of this form having been decided upon only after a very large number of forms used by individual houses, members of that association, had been thoroughly examined.

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# THE NATIONAL ASSOCIATION OF CREDIT MEN

Name of Firm ____________________________________
(Give it exactly, and spell it correctly)

Town ______________ County ______________ State ______________

Full Name of Partners?
______________ Nationality? ________ Age? ____ Married? ____
______________ Nationality? ________ Age? ____ Married? ____
______________ Nationality? ________ Age? ____ Married? ____

Stock Consists of? ______________

How Long in Business? ______________

Condition of Stock? ______________

Cash or Credit System? ______________

How Many Clerks? ______________

Location Relative to Business Center? ______________

____________________________

What are Local Opinions as to, Habits? ______________

Ability? __________ Expenses? __________

Your Estimate of Amount of Stock Carried? . . . . . . . . $ ________

Is it Insured? ________ $ ________

Value of Real Estate above Exemptions and Incumbrances? . . $ ________

Value of Other Assets? . . . . . $ ________

Your estimate total net worth above all debts, exemptions, and incumbrances? . . . . . . $ ________

Is he thought to be making money? ________

*Salesman* ____________________

**On reverse side give names from whom has been purchasing goods, and further remarks.**

FORM 17.—FORM FOR THE USE OF SALESMEN IN FURNISHING CREDIT INFORMATION.

**Names from whom has been purchasing.**

| | |
|---|---|
| ........................................ | ........................................ |
| ........................................ | ........................................ |
| ........................................ | ........................................ |
| ........................................ | ........................................ |
| ........................................ | ........................................ |

**Remarks:**

................................................................................

................................................................................

................................................................................

................................................................................

................................................................................

................................................................................

**Write no closer than last dotted line.**

FORM 17A.—REVERSE SIDE OF FORM 17.

The printed matter of this form appears on two sides, and if a salesman were to comply with its requirements in every case he would have to ask many questions of the present or prospective customer. It must be understood that this would require considerable of the salesman's time. Also, a person who was giving the salesman a first order might resent being asked so many questions; again, it is doubtful if a salesman could be depended upon to ask these questions with the intelligence that will disarm criticism and at the same time produce proper answers. These are questions regarding which there seems to be no definite policy followed in credit-giving. A salesman, particularly one who has not had long experience, should not be expected to understand the full import of all the questions noted on the form, or display much familiarity with them. Unless a report submitted by him be marked by intelligence and completeness, such a report is wholly lacking in value, and dependence upon it is attended with danger to the interests of the house. The questions that the salesman must ask the customer, if a report such as the foregoing is to be fully made out, would be, the name of the firm, the names of the partners, their nationalities, ages, whether married or single, how long the firm had been in business, whether it does a cash or credit business, whether insurance is carried, figures as to real estate owned, any other assets owned, and the names of parties from whom the trader is purchasing his goods. To do all this in a manner that will prove agreeable to the purchaser can only be expected of a man who has had a long and successful experience in salesmanship and who has been thoroughly coached in the credit duties required of a salesman. There are other questions which he will be able

to answer satisfactorily if his powers of observation be developed and acute, viz., of what the stock consists, its condition, how many clerks are employed, the desirability of the business location, his estimate of the value of the stock, his opinion of the value of the real estate, and the value of other assets. He is also expected to consult local authorities as to the habits, ability, and personal expenses of the customer, and also whether he is thought to be making money. No salesman can or will answer these questions with that degree of thoroughness which is essential to a good report unless "he has at least a rudimentary knowledge of the facts of commerce and a mind trained in the application of those facts of commerce to everyday questions."

It is true that these forms are used by many credit departments in the hope that the salesman will, through the fact of his being expected to send some information, make a report, if only a desultory one; but unless this feature of credit information be given thorough attention, a slurring or ignorant treatment of it will mislead the credit man in considering the information.

Form 18 represents a form which is of a much briefer character than the one described, it being a part of the order blank upon which the salesman sends in the full details of the order taken by him, the data in reference to the order appearing on the face of the form, and the information for the use of the credit department on its reverse side.

The questions asked correspond very closely to those heretofore mentioned. The questions as to the amount of annual license and its expiration are included because this particular form (Form 18) is used by a wholesale liquor

concern, and the question as to the amount of license, etc., is a very important item in that business.

Some credit men express themselves as unwilling to be influenced, either favorably or otherwise, by reports received from salesmen, on the ground that the salesman is in nearly every case actuated by selfish motives, his disposition being to give only such information as will be helpful in effecting a sale, and that he will withhold informa-

**PLEASE ANSWER FOLLOWING QUESTIONS WHEN YOU SEND ORDER**

What line of business? __________

Who compose the firm? __________

Age—and if married? __________

Business capacity (fair, good, or excellent)? __________

Prospects for success? __________

Habits? __________

How long in business? __________

If prompt pay? __________

If ever failed, when and where? __________

Capital invested in business? __________

Average amount of stock? __________

Amount of annual license? __________

When does same expire? __________

Remarks? __________

FORM 18.—BRIEF FORM FOR USE OF SALESMEN IN FURNISHING CREDIT INFORMATION.

tion of an unfavorable character for fear that he may lose a customer. This opinion, entertained by certain credit men consulted, is not a universal one, those in charge of the credit departments of some very large institutions holding that information received from salesmen, especially those who have followed the calling for a number of years, is of a most valuable character. In discussing "the salesman" a short time ago a writer said that his considerations were the following:

"First, himself; second, his customer; third, his house; and fourth, the credit man."

If this be correct, little dependence should be placed upon credit information from salesmen. The characterization is overdrawn, although with a certain class of salesmen their first consideration is usually themselves, and next to their own interests they desire to subserve those of the customer, forgetting that it is not the customer who employs them, and that their first duty is to those by whom they are employed.

The chief difficulty in developing this source of credit information is that the method involved requires a combination of credit man and salesman in one personality; while this combination exists among some men to a very marked degree, it is only infrequently discovered. The character of information obtained through a salesman depends almost entirely upon his personality. If he be a careful, conservative man he will exercise discretion in procuring his information, and endeavor to the best of his ability to safeguard his firm when it is extending credit. If he be a person who feels that this branch of his work is one not requiring a great deal of attention, or if he be

by nature disqualified from giving it the necessary attention, the results can very quickly be discerned in the reports submitted by him. One credit man has said on this point:

"It is my custom to exact of the agent a report of his own observation and impressions of the customer. I do not always get this and many times when I do it is of no value. I am to-day working with men who are as different as men possibly could be, one with a mind that is capable of analysis, careful observation, quick to be suspicious of little things that tend to affect a man's credit, and another who sees nothing, apparently knows nothing, but is always ready to venture the statement that the party is perfectly good, and 'don't owe a dollar in the world.' These reports, like all other information, have to be considered with their origin in mind, and in connection with other information which you have."

On the salesman's behalf it should be said that he is expected to sell goods and not to make credits, or rather, the selling of the goods is the primal motive of his occupation. Unless he is able to cover the territory assigned to him in a reasonable period and dispose of as large an amount of goods as the firm considers should be sold within that period, he will be looked upon with disfavor. An undue desire to make sales, irrespective of the probability of payment being secured, is very harmful to the interests of a house, but the following opinion expressed by a prominent credit man proves that such a policy does obtain among salesmen.

"It would be an assistance to the credit department if salesmen could be induced to use a little more judgment and not be too anxious to make a sale, but it is very difficult to get the information you absolutely require from salesmen. My experience has been

that there are very few of them who can size up a man in making a sale; in fact, I find that they are very apt to report favorably on a concern when it is not deserved."

The failure of the salesman to take a broad view of questions involved in the credit responsibility of his customers may be due to the failure of the credit man to inculcate among salesmen a proper respect for the responsibility imposed upon them as sources of credit information. If salesmen are not instructed in regard to this feature of their work they cannot be expected to discharge it with the satisfaction that would otherwise be secured. Some credit offices make it a practice to see that salesmen are thoroughly informed in regard to the condition of their customers' accounts, and are thus enabled to form a much clearer conception of the treatment that should be accorded the customer than if they were not in possession of this information. A credit man in a leading line has given the following description of this method:

"Each traveler when he starts out has in his pocket a book of convenient size showing the names of every man in every town he is to visit upon whom we desire he shall call. Opposite each man's name is a figure showing the limit of credit we are willing to give that man. We send to each traveler, so that he may know from ten to twelve days ahead of the date he is to visit the town, a paper which we call a 'statement of accounts.' It is ruled, showing notes, total open account, amount of open account due, and a line for remarks. The traveler looks over this paper and sees just how much a man on whom he is to call owes and what amount is overdue on a basis of four months, which are our terms of sale. On the line for remarks I am in the habit of saying something about each customer, so that the history of each man's account is given to a traveler before he reaches the town in which the customers on whom he is to call live."

If the credit man expects to secure through the salesman the information which will be of practical value to him in dispensing credits, it is his duty to cultivate close relations with the salesman and make the latter feel that his best work in obtaining reliable credit data will be appreciated by the credit office; that the more reliable the information he imparts, the less liability there will be to either crediting unworthy customers or dismissing applications for credit which really deserve favorable consideration. The effective treatment of these phases of credit will inure to the great advantage of the *salesman*, in that a desirable class of customers will be secured and their patronage retained for a long time, thus insuring *him* a steady and fruitful source of income.

There should be mutuality between salesmen and credit men. One of the important phases of this should be the education of the salesman as to his exact duties in regard to obtaining credit information, and helpful suggestions as to the best means for obtaining it. In this way, if he have that aptitude which is a distinctive characteristic of many of those with whom salesmanship is a vocation, a better means for obtaining reliable credit data will be afforded and a source of credit information developed which will possess many advantages.

## ATTORNEYS-AT-LAW AS A MEDIUM OF CREDIT INFORMATION

The second species of credit information to be discussed is that secured through the services of attorneys. There are many reasons why an attorney is an excellent medium for the procurement of credit information: first,

the organization of his office makes it convenient for him to act as a collector and distributor of such information; second, a lawyer invariably has a large circle of acquaintances, both of a business and social character, and this acquaintance enables him to secure information in regard to the circumstances of people to better advantage than others whose connections are not so extended; third, a lawyer's duties afford him much private information in respect to people's affairs, a large percentage of which information he is at perfect liberty to utilize as credit material without in any sense disclosing professional secrets; fourth, his daily association with matters in litigation opens to him an ample field of information, a good part of which is hearsay, but a large portion of which may also have considerable foundation in fact, and this information of either class can be judiciously diffused for credit purposes; fifth, he is frequently called upon to act as a collector of claims against people or in behalf of clients in cases where accounts are of a disputed character. The information he acquires through association with this work is of vital interest to credit givers and no better class of information could be obtained. There are entirely honorable ways in which this information can be conveyed to those who extend credit, without impairing the professional honor of the attorney. It is therefore natural that those who give credit should turn to attorneys as a medium of credit information. The utilization of the services of attorneys in this respect has been in the main satisfactory, although it has at the same time developed certain abuses which should not be overlooked. In their desire to secure collection and litigated business some at-

torneys, a number of years ago, proffered their services practically without charge in respect to credit information, in consideration of collections and other business being sent to them. Efforts were made to systematize this work by the preparation of lists of attorneys. Subscriptions were sought and accepted from mercantile houses and banks, the lists being placed at their disposal, with forms for use in asking for credit information and forwarding claims. Business houses and others, having paid a subscription price for the use of this book, seemed to feel that they should secure the latest and fullest information obtainable in respect to credit risks from the attorneys whose names appeared in the list. This scheme worked satisfactorily for a time, but it quickly developed that the attorneys were giving everything and getting nothing; for while a house might make inquiries on a large number of people, it was only in rare instances that it would feel called upon to enlist the services of the attorney. It was supposed that the policy of reciprocity would obtain under this system, but the advantages were not of an entirely reciprocal character, the balance being too much in favor of one side—the merchant's. As a result of this condition attorneys became indifferent as to the service rendered unless they were paid for such service. This has given rise to dissatisfaction among business men in regard to the attorneys' reports, a dissatisfaction which is freely expressed by many of the writer's correspondents, some of whom do not hesitate to belittle them. Credit departments that are availing themselves of attorneys' services for credit reports, assert at the same time that they do not place a great deal of value on them and that the service

is not satisfactory. It is charged that reports are not promptly made; that attorneys fail to go into the details of a case and depend too much on their memories and general knowledge of the standing of people in making reports; that these reports lack explicitness, and that meagerness of information is one of their principal shortcomings. On the other hand, there are credit men who rely upon attorneys' reports and say that it is their invariable custom to send a small fee with the inquiry, and that the results secured from this channel of credit information they consider valuable. The whole question resolves itself into this: that while there are cases in which certain attorneys may be inefficient or inattentive in the matter of credit reporting, these represent no larger a percentage of the profession at large than is represented by the inefficient and indifferent persons of any calling. When an attorney is found inefficient it is useless to continue to ask him for information, but if reliable and timely information is wanted, the only effective way to secure it (in justice to the credit office and the attorney) is to pay for it. That which a man gives for nothing is usually worth nothing. The theory of reciprocity, as it relates to credit reporting, has been worked to the uttermost, and its results are disappointing to those from whom the information is sought.

An effort was made some years ago by a committee of the National Association of Credit Men to have credit offices keep a card-indexed list of attorneys for purposes of credit reporting as well as making collections. Investigation indicates that these card lists are not in general use, and that in many cases where they were installed, they

On______________________________ ____________________

## THE NATIONAL ASSOCIATION OF CREDIT MEN

**41 Park Row, New York**

DEAR SIR:

Your name appears on our list as having represented us, or as being ready to look after our interests should occasion arise requiring your services.

Inclosed, therefore, please find one dollar for which kindly send us confidentially as complete a report as possible on **This Blank** on______________________________ especially answering the various questions specified. **Delayed Reports are of No Use, therefore be Prompt Please. Do not disclose our Name as Inquiring.** File our name as being interested in above business, and advise us at once of any change affecting his or their financial standing.

Yours truly,

Name____________________ Town____________________

County____________________ State____________________

Full names of all Partners.
________________ Nationality?______ Age?______ Married?______
________________ Nationality?______ Age?______ Married?______
________________ Nationality?______ Age?______ Married?______

FORM 19.—ATTORNEYS' REPORT BLANK.

How long in present business? ______ What amount of capital invested? ______

Ever failed? ______ When? ______ How did they settle? ______

Ever been sued? ______ Ever asked extension? ______ Is there any evidence of overdue indebtedness? ______ If so, of what kind and amount? ______

Reputation good, fair, or bad for ability? ______ Honesty? ______ Promptness? ______ Is he doing a good business? ______ Location relative to business center? ______

______ Is stock in good condition? ______

Your estimate of amount of stock carried? ______ $ ______ Of whom does he buy goods if you know? ______

Is it insured? ______ $ ______

Value of Real Estate above exemptions and incumbrances? ______ $ ______

Value of other assets? ______ $ ______

Your estimate total net worth above all debts, exemptions, and incumbrances? $ ______

## REMARKS

Any answers which cannot be made in above spaces kindly indicate by some mark and amplify here

______

______

______

______

Attorney's Name, ______

**Do not Write below Heavy Line**

FORM 19A.—REVERSE SIDE OF FORM 19.

have been discarded. The principal reason for the elimination of the card lists of attorneys as a feature of credit-office work is that during the past few years there has been developed a large number of excellent law lists which are in use by credit men. These law lists are prepared under the auspices of responsible concerns and published in attractive form. Revisions are made with due regularity and a list of this kind obviates the necessity of the credit man keeping a card list of his own, the proper attention to the preservation of which would require constant thought and care. Another advantage of the lists published in book form is that in nearly all cases the names of attorneys appearing in the list are under contract with the publishing company to furnish credit information.

In Form 19 is submitted a form of attorneys' report blank which has received the indorsement of the National Association of Credit Men.

One of the first things set forth in this form is that the sum of $1.00 is inclosed to pay for the report asked for. This amount would be recognized as a fair compensation for an average report. If, however, the preparation of a report involved considerable research of county and other records and much interviewing of local authorities by the lawyer or his representatives, the fee would not adequately cover such services. It is presumed that considerable of the information could be entered upon the blank without loss of time or references to papers or people. At the same time, in a case where the attorney had prepared a report as asked for, and received a second request for a report upon the same person within a short

time, the task of bringing the information down to date would be simple and the compensation mentioned a *very* fair one. Many of the questions in this form are the same as in the salesman's blank and therefore do not require further explanation. The form embodies many of the essential elements of the blanks furnished by the law-list companies. When detailed information is required, in respect to real estate holdings and liens upon them, the services of an attorney are necessary. He and his clerks are qualified to search for and impart such information intelligently, although his assistants may not be entirely fitted to act as investigators on general credit matters. While no attempt is made to disguise the fact that the services of attorneys on the question of credit reporting is not held in universal esteem, in justice to them, and especially to those members of the profession who have made a determined effort to acquit themselves creditably in this work, it is proper to quote a few opinions of prominent credit men which are highly favorable to attorneys as gatherers of credit data, and also set forth reasons why their services are desirable. For example, this from a Chicago credit man:

"I consider attorneys' reports as among the most valuable of our sources of information:

"First: Because they are from men right on the ground. Collection attorneys, *for the most part,* give honest information.

"Second: Because the information so obtained is comparatively inexpensive, being paid for almost wholly by an exchange of business.

"Third: Because a good idea can be formed of the attorney's collection ability from the nature of the report he makes, and his care in making it."

The following from a leading representative of the credit profession in Baltimore:

"My experience seems to warrant the opinion that the attorney's assistance in the investigation of credits was frequently more valuable than his direct assistance in making collections. The attorneys used were generally recommended by some reputable company or those I had met in the course of my credit experience."

The last opinion cited is that of a credit man of a representative Boston concern:

"The local attorney in many instances is thoroughly familiar with the habits of the party to be investigated, also his manner of living, amount of business done, and how he stands socially and financially in the community. He is also in a position to know of any real estate recorded, also mortgages, and in many instances knows when accounts are in attorneys' hands for collection. Attorneys report promptly; in most instances by return mail. Blanks are furnished by companies supplying the law lists, and it has been the writer's experience that printed forms containing regular questions to be answered are more satisfactory than a blank form, as attorneys will simply reply in a general way."

In certain cities of the first and second class, law firms doing a large commercial business have found that the services they have rendered in credit matters have been of great benefit to them in the acquirement of a large number of clients whose commercial business is of a very profitable character. These law firms have installed commercial departments, one of the principal duties of which is to gather credit data. The consequence is that the work is done in a systematic and thorough manner; those charged with its prosecution become, by association with

it, experienced and proficient; and another very great advantage is that after a number of years the constant accumulation of credit information provides a set of files equal, and in many cases superior, in value and material to those held by the mercantile agencies.

## BANK REFERENCES

Some credit departments consider it a good practice to address letters of inquiry to banks soliciting their opinions of applicants for credit. It cannot be said that the information acquired in this way is of a great deal of value, for the reason that the bank should not be expected to, and neither will it, tell in plain words just what line of accommodation it accords a man or the exact state of its account with him. While it is hoped that the day may come when a bank's relations with its customers will be looked upon as disclosable facts (in the same sense that business houses freely open their books to one another), it cannot be denied that for banks to explain in detail the nature of their relations with customers would in a good many instances result in trouble for all concerned. Some houses might be so timorous as to feel that they were not safe in extending reasonable credit lines for merchandise, because a man was owing his bank a considerable amount of money, obtained through the ordinary channels of bank accommodation. The contraction of his credit due to such fear would prove harmful to his business reputation.

This leads to the thought that a closer *relationship* between mercantile interests and banks is desirable on the

subject of credit interchange, as the influence of both would be widened and many severe losses obviated. Credit interchange consists not merely in stating whether a man is prompt or slow, but in the diffusion of the great mass of information assembled from all quarters and distributed for the benefit of all interested. When questioned on this subject bankers have replied, "Banks have no information to give, they cannot be expected to tell the private business of their customers." To do so might have the effect of driving some customers away from the banks with which they were doing business. It is true that the relations of a bank with its customers are of a more private character than the relations of these same customers with houses from which they purchase merchandise. There are certain reasons for this:

1. A merchant is usually debtor to his bank in a much larger amount than to any individual house with which he is dealing.

2. In order to secure the accommodation he desires he may have induced some relative or friend to guarantee his account with the bank, and if the latter is expected to give out such information as this when called upon by a merchandise creditor (who may have only a trifling order at stake) it would have to disclose the fact of the account being guaranteed.

3. Such information might be misinterpreted and lead to rumors that the merchant must be weak, as his bank required a guarantee for his account, and such rumors would do incalculable harm.

Conditions such as those referred to are probably

accountable for some of the opinions expressed by one of the writer's correspondents:

"The banker and jobber do not get along in the way of commercial reports. It is well known to credit men that very little reliance can be placed upon a report given by a bank upon the country merchant. If the merchant is not doing business with the banker, the latter simply returns the inquiry saying that he is not doing business with him, or gives information which is not of much value. We had a customer in a town in which there were three banks. We knew the customer to be slow pay and were in doubt as to the continuance of the account. I sent an inquiry to each of the three banks regarding this merchant. One bank stated that he was slow pay and they frequently had drafts on him, very few of which were paid. (This information coincided exactly with our own experience.) The second bank said that they did not believe that the party was good for the credit named, as he was too slow, and they could not recommend him for the accommodation. The third bank stated that he was prompt pay, a responsible party, and good for his needs, and that they would not hesitate to recommend him for the amount of the order in question. It is easy to see where this man kept his bank account, and also that he had had some trouble with one of the banks. If our inquiry had been directed only to the third bank, you can see what misleading information we would have had."

The statements contained in the foregoing are typical of the views frequently expressed by credit men in respect to bank-credit information. They are not complimentary to what is recognized as the most powerful agency in our whole commercial structure (the banking business) and it is probable that a good deal of the displeasure entertained by merchants and credit men on this question is due to: first, a misconception of the information the bank should be expected to impart; second, the nature of its relations with its customers; and third, the danger of an indis-

criminate diffusion of the inner facts relating to bank accounts.

In justice to the banker something should be said of the criticisms in the excerpts quoted.

1. As to his returning an inquiry upon a person with whom he is not doing business, and giving information which is not of much value, the point is, should he be expected to give out information as to why the man inquired about may have been compelled to close his account at the bank, or, on the other hand, if the bank has never done business with him, should the banker be expected to act as an advising medium at the expense of his time and with no recompense for his labor or information?

2. The information of the first bank cited was, according to my correspondent's own statement, a truthful one, and one that confirmed his own experience. The same thing may be said of the information of the second bank.

3. The third bank was certainly at fault, probably through ignorance of the merchant's real reputation as a business man, although some might say a harsher judgment was warranted. Dismissing the bank's culpability in this particular case, the incident cited shows that information sought in this way, or among merchants as well, is not always reliable and that all information must be weighed in connection with the general aspect of the case, otherwise such information will mislead and do harm that cannot be satisfactorily repaired. Information sought by merchants from banks through correspondence is not meted out in a measure that proves agreeable to the merchants. Some of the reasons for this have been explained, and there will be no appreciable change in this condition

until such time as credit interchange is liberally practiced among the bankers themselves; when that state of affairs obtains, the next step will be the recognition of the interdependence of bankers and merchants in the matter of credit interchange, with results that will be eminently gratifying to the commercial interests of the country.

# CHAPTER X

## SOURCES OF CREDIT INFORMATION—*Continued*

### (*B*) *Written References and Inquiry Forms—Written and Signed Statements—Oral Investigations—Traveling Credit Representatives and Special Reports*

### WRITTEN REFERENCES AND INQUIRY FORMS

ONE of the common practices of all trades is to ask a person for his references when he is making his first purchase. It is proper to consult the references that the applicant for credit may give, but the credit man must not stop there. It is not probable that the applicant for credit would tender the names of people other than those with whom he stood well, and it is not to be supposed that he would recommend the men from whom he expected a credit favor to go among those who did not entertain a good opinion of him. The tremendous increase in the number of those engaged in trade during the last twenty-five years has necessitated a great volume of correspondence on the subject of references, and in order to systematize and minimize the labor imposed upon credit offices, reference forms are used. In their earlier use these forms simply requested information as to whether a man was prompt or behind in his payments, and a general estimate of his character. Either below this printed matter or on

the opposite page there were lines for the reply, and it followed that the information in response to such an inquiry would be general and evasive in its terms. In order to obviate this difficulty and to still further minimize the work of the credit department, forms were prepared containing certain questions opposite which the recipient was supposed to note his replies. If answers were given to an inquiry of this nature there was little possibility of evasion or double dealing, for the character of the questions would prevent it. In Form 20 is given a form of inquiry or reference blank.

This blank is also one adopted and recommended by the National Association of Credit Men. It is the latest development of a series of inquiry forms prepared by the committees on Credit Department Methods of that organization, and in its present shape represents probably as succinct an inquiry blank as there is in use among credit interests.

This form is prepared in the manner shown in the diagram: the same printed matter which appears here appears also on a duplicate sheet attached to the form given, with the exception that instead of the words "Our Experience. Keep this for your files" there are the words "Return this to us." When an inquiry is to be made the stenographer or other clerk enters the date, the name of the party to whom the inquiry is addressed, a notation as to whether it is a house sale or an order, the amount, the name of the party inquired about, and the latter's post-office address. Below the double lines are entered the answers showing the experience of the inquiring concern; in sending to its correspondent this information the inquirer is giving quite as much as he expects to

## OUR EXPERIENCE

**KEEP THIS FOR YOUR FILES**

Mess. ______________________ New Britain, Conn. ______________________

______________________ We have __________ order, $ ______________

from ______________________ P. O. ______________________

Kindly favor us with your experience and opinion

Yours truly,

**GOCD FORM & COMPANY**
Boots and Shoes

This blank is adopted and recommended by the National Association of Credit Men, of which we are members.

How Long Sold? ______________________

Terms ______________________

Highest Recent Credit, $ ______________________

Owes $ __________ Past Due, $ ______________________

Pays ______________________

Other Information ______________________

______________________

______________________

______________________

FORM 20.—TRADE INQUIRY FORM.

receive; and when the recipient returns the form with his information, he has really given no more than he has received.

These forms are in great demand and are also largely copied either in their original form or with certain modifications, made necessary by the exigencies of special trades. It is the general testimony of credit men that these applications for credit information bring prompt and satisfactory replies. This is due to the fact that reciprocity plays a prominent part in the transfer of information, and the labor required is in no sense an imposition.

In certain contingencies, however, the nature of the inquiry may be such as to render the use of a printed form inexpedient. In its place should be sent a letter setting forth the exact nature of the inquiry and the information desired. If the extension of credit is to be conducted so as to subserve the best interests of those engaged in giving credit, it is essential that there should be perfect freedom in the interchange of credit information.

Although the principle of credit interchange is recognized as one that should be followed by business houses, there are credit men who feel that the work of answering a large number of inquiries is an imposition. Some disapprove of this system to such an extent that they will neither make nor answer inquiries. This policy may be followed in a business where the article dealt in is of a patented or standard character, enabling the firm to confine its trade to only those who enjoy the highest ratings; but in a business where competition is general it is evident that such a policy would be attended with disastrous results.

The information received on an approved inquiry form

must not be always accepted at its face value but should be studied with the same care extended to a detailed statement of affairs received direct from a customer. Houses ultra-liberal in extending credit are not as reliable guides as those known to be conservative. In other words, the character of the house giving the information must be considered as affecting the information and any omission to follow this course is a mistake. When inquiry forms are of a general instead of a detailed character, the answers may be very misleading.

## WRITTEN AND SIGNED STATEMENTS

There are certain facts which can be obtained with better success from the applicant for credit himself than from any other source. The details as to the value of his stock and other items of assets, and also his business liabilities and private indebtedness constitute information of which he is the exclusive custodian. It is essential that he be asked for this information, and the safest method of securing it is through the medium of a carefully prepared printed form, containing such questions as the creditor has a right to ask, signed in person by the applicant for credit. The latter suggestion should be emphasized for the reason that in some States it is impossible to proceed in a criminal action against a man on a signed statement unless he has personally signed it. In many cases merchants see fit to have these statements signed by confidential clerks or buyers, but in some States such a signature would not bind the principal. The great merit of securing a statement upon a prescribed form is that there are set before the applicant for credit or debtor the

questions to be answered, and his failure to respond to any of them is ground for prompt inquiry as to the omission, very often disclosing conditions of an unfavorable character. If the purchaser prepares his own statement he may, by clever manipulation, effectually veil unsatisfactory details that should be unfolded.

Personal statements are regarded as one of the most effectual methods for securing reliable data in regard to accounts.

It is well to consider whether a very large number of questions such as appears on Form 21 does not confuse the person who is to make the statement and also inspire an unwillingness on his part to submit to what may be regarded as an inquisitorial proceeding. This point has been studied by many credit departments, with the result that they have deemed it expedient to employ a simpler form, a type of which is shown in Form 23.

A question appearing in statement form, Form 21, to which attention should be given, refers to whether or not books of account are kept by the applicant for credit. This is a question which has been overlooked to a great extent in the past, although its relation to the bankruptcy law is one of such intense interest that it is somewhat remarkable that the omission was not discovered earlier. This question, however, has been rendered absolutely essential, if these forms are to be used in the State of New York, as certain legislation adopted by that State provides that it shall be *prima facie* evidence of fraud if a merchant has obtained credit on the strength of a signed property statement, in which he claims to keep books of account, and not making payment when due, he fails to submit

his books of account within ten days on the requisition of a creditor on whose account he has defaulted.

There appears to be no uniform policy followed by credit departments of commercial houses or banks in regard to asking for property statements. Some believe that they are safe in depending upon the information secured through other channels if such data as comes to them is of a satisfactory character, and recourse to a demand for signed statements is made only when the credit man considers that the general information he has secured is not adequate. As explained in the following opinion:

> "In case of any discrepancy between the reports of the two mercantile agencies, or where the reports have been vague and unsatisfactory; as for instance when the report reads, 'It is *reported* that this party owns a certain amount of real estate in his own name,' we have usually required the customer to furnish us a statement which we have verified by records."

Some credit men are not in the habit of asking for property statements except in the case of an entirely new account, while others do not request property statements at all if they feel that they can get along without them. The situation in commercial circles on this point is exactly the same as in the banking community, viz., as a rule men are not inclined to give statements of their affairs if they can avoid doing so. The lack of uniform procedure on this as on many other points shows that there is still considerable work to be done in credit organizations if the business of the country is to be reduced to the safe basis upon which it should rest. Another advantage in using property statements is as shown in the following opinion, which is from a credit man of excellent training and long experience:

"We insist on signed statements from the majority of our customers at least once a year, and in many cases twice, or at least we require to know at the half year as to their indebtedness. This is a good thing for the customer as well as ourselves. The oftener he can look the facts as to his condition in the face, the better. The country merchant generally is not very systematic in his accounting. A large number of the statements we get are taken on the ground by a representative from our office, who can at the time discuss and advise regarding the various features."

In analyzing statements it should be borne in mind that, under scrutiny and the liberal use of the blue pencil, often items which seem most roseate at first sight disappear as factors when subjected to a process of analytical reduction. The quick or realizable assets must be separated from those which are slow and unproductive; for upon the former depend the receipts to sustain the business. When making a statement a man will naturally place the largest possible valuation upon his belongings. He does this believing that the merchandise and accounts are worth "that much" to him, but when these items of assets are weighed in the scales of impartial judgment they shrink appreciably. In addition, there are items appearing in nearly all statements made by firms and individuals which must be considered at only a certain value. For instance, every State has its exemption laws, and the citizen is entitled to his exemptions. It not infrequently happens that a house and lot entered in a statement as an asset, presumably at the risk of the business, are claimed as an exemption when a failure occurs, and in localities where there is a personal property exemption, if the debtor elects to claim his exemption he can take a portion of his stock, and invariably gets the best portion.

## ORAL INVESTIGATIONS

In no field of credit information are better results secured than through the instrumentality of oral investigations. The latter are necessarily confined to inquiries and researches among concerns residing in the same city as the house pursuing the investigation. In large cities this character of credit information is industriously sought and secured in a volume which represents probably a larger return for the time, labor, and expense involved than any other method of investigation followed by credit departments.

Such investigations are conducted by clerks representing the credit department of a house, who carry a list of the persons that are subjects of inquiry, and who visit all business concerns to whom the person inquired about may have referred. Quite as important, they must visit houses in the same trade and every other house that might by any possibility be possessed of information which would affect the standing and responsibility of the concern under investigation. It is well to consult personal as well as business friends of the man seeking credit, for from the former may be gleaned information concerning his personal habits and mode of living, which will be of great assistance to the credit man. Prominent credit men have admitted that they have been saved from serious losses by insisting upon the settlement of accounts when information showing personal deficiencies came to their attention. The clerks to whom this work is intrusted usually represent the minor help in the credit departments; and investigating work is the apprentice period of those employed in credit offices.

The investigator is expected to frame his own questions, and the character of those questions will determine the nature of the information he will elicit. The interested and watchful investigator will very quickly discern whether the credit man, to whom his questions are addressed, is answering them in a straightforward manner, or whether he is endeavoring to conceal anything.

The credit investigator is to commerce what the reporter is to journalism. They discharge similar duties in their respective fields of labor. The expense involved in retaining in the service trained and competent investigators disparages the possibility of using them generally outside the cities in which their employers do business, as there would be added to the salary list the expense of traveling. The merit of this mode of investigation has led to the employment of credit men, who travel in quest of credit information throughout the territories in which their houses principally operate. This will be explained in the next section.

## TRAVELING CREDIT REPRESENTATIVES AND SPECIAL REPORTS

Credit reporting, through traveling representatives of credit departments, is an advanced form of credit work made necessary by the large number of accounts appearing upon the books of wholesale and jobbing houses, and the further necessity of exercising a careful supervision of certain accounts that may show a tendency to lag in payments or display other symptoms of commercial weakness. It has become the custom, however, on the part of houses extending liberal lines of credit, to utilize the services of traveling credit men in visiting all classes of trade, and

in fact making a thorough investigation of every concern within their territory.

The traveling representative fulfills in a much more important capacity, and to a greater degree, the functions described in the foregoing section as belonging to credit investigators. The principle upon which he works is exactly the same, although the detailed results of his efforts must represent a great deal more to his firm than is expected from the local investigator. A man is not qualified to act in the capacity of traveling credit representative unless he has had a thorough schooling in credit work in all its branches, for the reason that the work he is called upon to do covers nearly every phase of credit economy. His judgment is required by his employer as to every question that enters into the life of an account or credit, and unless he has had the requisite experience he cannot meet the requirements of his position. When a traveling credit representative leaves on a trip he carries with him a record of some description providing him with the essential facts in relation to the people he intends to call upon. Quite as important, he must have a general knowledge of the different accounts kept with his house by the people he purposes to investigate and interview. He must also have a reasonable understanding of the characteristics of the customers of his concern, otherwise he cannot approach or "handle" them with the tact which is extremely necessary in his field of labor. His work consists not simply in visiting the customer, having a talk with him in regard to his business, and asking for a statement of his affairs. It extends to making an examination of the customer's books if the necessity for so doing should develop, and also looking through the stock of merchandise in order to determine

in what condition it may be. Having made a critical analysis of the books and merchandise, he must then make such further investigations among the banks, mercantile agencies, and other authorities as he deems advisable. One of the duties to which reference has been made would appear to call for special attention, and that is the question of the credit man making an examination of the customer's books. This would presuppose an expert knowledge of bookkeeping, or, as it is called, "accounting." Some credit men and writers on credit topics have gone so far as to contend that a credit man's professional equipment is not complete unless he be an accountant. Many of the ablest credit men in the country are not accountants, expert or otherwise, and this fact does not detract from their great ability as credit men and successful administrators of the credit office. There is no disposition to scoff at or discourage a thorough knowledge of bookkeeping on the part of credit men; on the contrary, it is a study that could be undertaken with profit by all interested in credit work.

Among the advantages accruing to a house through the employment of traveling credit representatives is its ability to secure from him an opinion as to the local conditions surrounding people whom they are trusting. At times depressions will affect localities that have formerly been quite prosperous. Untoward local conditions can sometimes be foreseen through investigation in the locality, and this is one of the respects in which the work of a traveling credit representative is most efficacious.

In some cases, especially when the amount involved is a large one and the information obtained is not of a decisive character either favorable or otherwise, it is advisable to procure a special report. This can be done through

the mercantile agencies, good law firms, or both, the credit man explaining, when making the request for the special report, the exact details he would like to have covered, and the points in which he is most interested. Where a house can afford to do so, however, these are the cases which should be intrusted to traveling credit representatives, for the latter are better informed as to the nature of the difficulty in each case, and their knowledge of credit work enables them to reach and act upon the vital points involved in a manner in which an outsider could not conduct the required investigation.

# CHAPTER XI

## SOURCES OF CREDIT INFORMATION—*Continued*

### (*C*) *The Mercantile Agency*

The best known and in some respects the most important fountain of credit information is the mercantile agency. The two institutions that contribute the bulk of mercantile-agency service are often referred to as indispensable elements in the determination of the extension of credits. Fifteen or twenty years ago the assertion as to their indispensability would have passed unquestioned, but such is not the case to-day. The fact that the mercantile agencies diffuse a great mass of credit information leads people to believe that it would be impossible to dispense with the services of these companies. Those in the mercantile-agency business make a special point of this, and press it at every opportunity. Among credit men, however, there is a distinct feeling that while mercantile-agency service is valuable, it is not indispensable. In fact, credit representatives of important establishments incline to the opinion that, compared with other classes of credit information, it is of a secondary character. There are special agencies organized to report certain trades, the work of which is so thorough, especially in regard to ledger information, that it is looked upon as superior to the average mercantile-agency service. The following opinion of

a leading credit man of New York City reflects this sentiment:

"My personal opinion with regard to credit matters as a whole is that while such concerns as Dun and Bradstreet may, perhaps, always be, to a certain extent, of value, I am convinced that their value is daily becoming less and less in proportion to the increase in population and therefore the increase in business houses. I believe that credit bureaus are the most desirable means of acquiring credit information, not only because one can get (if these bureaus are properly managed) practically the same information that Dun and Bradstreet do—by means of communicating with local attorneys—but because they give from day to day the exact indebtedness in each trade of the person or house seeking credit, barring, of course, banking indebtedness."

This criticism will be regarded as having its inspiration in the failure of mercantile agencies to extend their system of acquiring trade information to the limits desired by credit men, but it is obvious that other and quite as compelling motives have aroused unfavorable views of agency service.

In estimating the value of mercantile-agency information, credit men often labor under the error that the mercantile agency should provide information that will in itself determine whether or not an account should be opened or continued. To place upon agency reports the dependence involved in this idea would be relinquishing the deciding voice to outside institutions, which, although well organized, are subject to the same fallibility as any other human individual or institution. The agency traces the business experience and antecedents of a person in trade; acquaints itself with the facts in regard to his character; learns from others his general reputation, both in a personal and business sense; investigates his means

and the extent of his business; and should also direct its energies to determining the standing of the man with those who sell to him; the latter duty referring to trade information or ledger experience, which has become a special branch of credit reporting.

One of the great advantages of agency information is its use in corroborating other information at the disposal of the credit department. It serves to verify entries contained in a personally signed statement. It is useful in affording the credit man an idea as to the character of the applicant for credit; and a *well-thought-out agency report* should aid him materially in *forming his own judgment* as to the risk to be undertaken. Credit-givers complain that in some cases they have been misled by agency information, and while this may be true, it will very often be found that the trouble arose from reposing too much faith in generalities without resorting to such methods of confirming the reports as are at hand in every well-equipped credit office.

The mercantile agency movement had its origin in the organization of Messrs. R. G. Dun & Co., although in its first years the name by which it is now known throughout the world was not connected with it. A reliable authority, in speaking of the mercantile agency, says that "It originated in the United States during the period of depression following the panic of 1837, and its avowed object was to uphold, extend, and render safe and profitable to all concerned, the great credit system which had grown up with the increase of commerce. The first mercantile agency was established in New York, during the year 1841, by Lewis Tappan." In his work on "Giving and Getting Credit," Mr. Fred. B. Goddard says:

"The business of the agency was at first limited; but in 1846, Mr. Benjamin Douglass was admitted to a partnership with Lewis Tappan, under the style of Tappan & Douglass, and he at once assumed the chief management and extended its operations. In 1854, Mr. Douglass succeeded to the business, and the style of B. Douglass & Co. was adopted, with the admission of Mr. Robert Graham Dun. 'The Mercantile Agency' now made rapid and substantial progress, and soon gained a recognized and assured position among the useful and necessary mercantile institutions of the country. In 1860 Mr. Douglass withdrew, and ever since that time Mr. Dun's name remained at the head of the agency."

The foundation of The Bradstreet Co. took place some years subsequent to that of Messrs. R. G. Dun & Co. In a paper on "Credit—Its Meaning and Moment," written by Mr. Clark W. Bryan, editor and proprietor of the *Paper World and Manufacturer*, and published in 1883 (Bradstreet Press), he gives some facts in regard to the earliest history of this institution. It appears that in 1848 Mr. John M. Bradstreet, a lawyer of Cincinnati, had charge of a certain insolvent estate. His work in connection with it was evidently an extensive one, during which he became familiar with the standing of bankers and others in and around Cincinnati. He was also brought into close relations with prominent New York interests, and this combination of circumstances suggested to him the advisability of making arrangements with his New York connections to furnish them with information relating to their Western customers. He was successful in carrying out his plans, and in 1849 "Bradstreet's Improved Mercantile Agency" was opened. Henry Bradstreet, a son of John M. Bradstreet, afterwards became associated with the business, and the style was changed to J. M. Bradstreet & Co. J. M. Bradstreet died in 1863,

and in 1876 the concern was incorporated as "The Bradstreet Co." Mr. Charles Finney Clark, who, until his death in 1904, had been for many years the president of this company, became connected with it in its early days and to his genius and untiring energy are due the influence and prominence of the concern. Following closely upon the organization of the business started by Lewis Tappan, were several similar enterprises, none of which, however, has survived. The fact of the failure of other attempts to successfully develop mercantile agencies has given to the Dun and Bradstreet companies a reputation for solidity and superiority that accounts to a great extent for the fame and prestige they have enjoyed for so many years.

The scope and influence of mercantile-agency work advanced very rapidly, and the disposition of the leading companies to extend the field of their operations in accordance with the requirements of the mercantile community created a strong sentiment in their favor and proved a profitable policy to the agencies. The development of these organizations is worthy of much praise, and has proved a boon to the business man, enabling him to obtain information in almost any part of the world within a short space of time. They have traversed every section of our own territory, and established either branches of their own or adequate connections with other avenues of information in the Old World. The part that the mercantile agencies have played in the upbuilding of the commercial structure should not be overlooked. As explained in the discussion of commercial credit, in a new and crude community, there is a great demand for credit, and the willingness of the merchants of the older localities to extend

credit to pioneers has been regulated and assisted by the operations of the mercantile agencies. Even if the information acquired by them was meager, they had the prescience to either send to or secure representatives in new sections, who advised them with a fair degree of intelligence and integrity as to the character and capacity of credit seekers. This information, when sent throughout the business world with the name of either of these great companies as a *quasi* guarantee of its correctness, has exercised an influence of incalculable value in developing the commercial progress of the last fifty years.

Another feature of the work of these companies which has helped to establish their names, as well as the assumed reliability of anything which proceeded from them, was the review of trade conditions and market information they have distributed weekly for many years. This information continues to be accepted by the press of the country as probably the best authenticated index of financial and industrial conditions that could be consulted. The acquirement of this information, from the many different points of trade activity, has imposed upon the agencies considerable expense and labor. That they recognize in the transmission of this information a powerful help to their own advancement does not detract from the merit of the service they have rendered. The transfusion of general information and data showing the condition of affairs in different markets has also been of great assistance to business men in shaping their own plans, and especially in measuring credit conditions.

Credit men frequently express opinions to the effect that the service of the agencies is not as prompt as it should be; that they find it necessary to check the regular agencies

by attorneys' reports; that where quick service is required they avail themselves of the facilities furnished by special and trade agencies; that neither of the agencies comes up to requirements; and that special agencies are much more efficacious. Mr. James H. Eckels, president of the Commercial National Bank of Chicago, said in his lecture on "The Methods of Banking," before the University of Chicago:

"At present the banks must rely to some extent at least, on the mercantile agencies for information on the status of men engaged in business; but these reports have been found deficient in that they are so general in character and so limited in giving the information which is essential to forming a judgment as to the extension of credit."

Those who have been associated with the organized credit movements as they have existed are cognizant that there is a demand for a greater discrimination in ratings, and that additional characters to those already used should be employed to designate not only the credit standing and approximate means of the person rated, but his paying qualities as well. The most important element of disapproval of present agency methods is the failure to respond to the ever-increasing demand for ledger information or trade information. It should not be presumed that because one calls attention to certain palpable and undeniable facts, that he is necessarily an unfriendly critic. It is required when stating a case to state it all; some of the charges against agency service are sound and some are not; at least, this is the judgment of the writer.

(1) In respect to delays in service: These delays are in many cases due to a desire on the part of the agency representative to furnish a report that will be one re-

flecting that "greater accuracy" that the credit men are looking for. In a recent publication on credit, it was stated that one day was all the time required in which to prepare a good agency report. There are some reports that can be prepared in one day and others that cannot. There can be no arbitrary time limit established or successfully defended for the preparation of an agency report.

Agency work is *prompt* if it be executed with that reasonable expedition that admits of full attention to all the necessities of each individual case; delay, so called, is sometimes in the direct interest of the credit-giver, as it may provide him with data that fictitious promptness would not have supplied.

(2) Regarding the express necessity of checking agency reports by attorneys' reports: Corroboration of every kind is an element of good credit office management, and the method suggested could be resorted to with profit, even if there existed no doubt as to the correctness of agency information; while a resort to generalization on the part of the agencies is not commended, it must be conceded that in the preparation and editing of the voluminous matter that proceeds from the agency offices, there must of necessity be a condensation of the data on which the report is based. On the other hand some lawyers give very satisfactory information, and set out all the features of their reports in more detailed form than would appear in the average agency report. This exhibition of detail might lead to the belief that the attorney's report in such a case was of more value than the agency report, although the sum of the information might be exactly the same. It often occurs that the attorney who acts directly for the credit department is also the representative of a certain

large agency, and in this case there would be no real *corroboration.*

(3) As to the claimed superiority in promptitude and general service of special agencies over the mercantile agencies; it is well known that many of these special agencies are organized by trades or business communities for their own protection, and even when not organized by the business men themselves, they are in the control of people who are conceded special advantages in the procurement of information by the different trades. Other special agencies are conducted on coöperative lines, and are enabled to get information in more detailed form than it is extended to the regular agencies.

(4) Criticisms have been leveled at the agencies for their lack of detail, and especially in respect to statements (signed or otherwise). The influence of the mercantile agencies is recognized by all classes as being a most important one. Among the intelligent of those who seek credit there is reasonable appreciation of the necessity of complying with the requests of the agencies, and thereby assuring a rating and report that will be an honest reflection of the standing of the merchant. There are at the same time a very large number of people who regard the work of the agencies as being a spying process to which they should not be subjected, and among this class there is a distinct unwillingness to comply with such requests as the agencies may make. It is sometimes difficult for an agency man to induce a merchant to talk even in a general way in regard to his affairs, and in such a case it is much harder to induce the merchant to give to the agency a detailed written and signed statement of his affairs. He does not regard this as a necessity, and very often replies that

he can get all the credit he wants without the help of the agency and cares nothing for its rating. How far the agency should be criticised for its failure to secure statements from people of this class (a very numerous one) is a question to which patrons of the agencies probably do not give sufficient consideration. If a man is seeking credit he is likely to comply with a demand from a creditor for a statement, rather than from the agency, whose desire to give him a rating he ascribes more to its wish to make money than from any relation the agency bears to commercial life.

An investigation made in the year 1902 showed that about 37½ per cent of the reports submitted by the agencies contained statements secured from people in trade. There are a great many from whom it would be a waste of time to solicit statements, and idle to consider them if obtained, such as people of small means, saloon keepers, newsdealers, milliners, and others, whose unfamiliarity with business methods is self-evident. These small dealers constitute quite a percentage of the aggregate of those in business and must be eliminated from the number of those from whom statements should be secured. Therefore the difference between the 37½ per cent mentioned and the maximum of 100 per cent does not represent a deficiency in agency work, as some might be led to suppose. The practice of giving statements of one's affairs is more general than it used to be, and the agencies are getting the benefit of this progress and show it in the class of reports they are issuing. This argument, however, does not account entirely for the alleged deficiencies in reports and absence of accuracy. The latter conditions are traceable to the fact that many agency representatives and reporters have

had little if any commercial training, and really do not understand the scope of latter-day credit information.

(5) The demand for additional significations as to the capital and credit standing and paying qualities of business people: This refers to the ratings appearing in the reference books of the agencies, and is a question which has been agitated for some years by certain credit men. This idea has been approved by the credit organizations, and the agencies have been urged to incorporate this change in their reference books.

The object sought is to have the agencies designate in the rating column, in addition to the approximate capital of the trader and his credit standing, the nature of his paying qualities; a man may be in good credit, that is, he may be able to command such credit as he requires, but at the same time may be backward and unsatisfactory in his payments. In order, therefore, that the subscriber may know by glancing at the rating column just what a man's capital, credit standing, and paying qualities are, the agencies are expected to designate the relative degree of all of them.

The motive of this demand is that the reference books alone should give sufficient information upon which to stake a credit. The agencies should not be expected to undertake the labor and expense of securing the material for their reports solely to furnish ratings; the latter are guides only, and when expected to fulfill any more important function, a wise dependence on credit information has been abandoned.

The refusal of the agencies to comply with the views of credit men in this particular impelled two recently formed (but now extinct) agencies to adopt this feature

in the hope of profiting by any displeasure the old agencies may have incurred. But unless it can be shown that "pay ratings" are based upon a thorough preliminary investigation and frequent re-investigations, pay-rating designations are not to be relied upon. A man's methods of payment are, as has been said, of a varying nature; what is considered prompt pay in one trade is not quick payment in another, for the terms of settlement widely differ. A man may discount his bills one season when money to move the crops has flowed easily, and the next year be compelled to take full time, and it may be long time. His capital and credit standing may not be affected, but his habit of payment has changed; this would require a change in his pay rating; a lowering of that rating would provoke unnecessary alarm and probably do him a great deal of harm. Further, the ratings must be based on revisions that have been made several months prior to the time the books go to press. It will be said that the reports are just as old; true, but the reports can be revised quickly and changes noted, whereas an *entirely new book* cannot be printed every month.

Further, the wisdom of pay ratings is open to serious question. It is well known that a man may discount his bills with a certain class of houses, take full time with others, and be slow with others. It is often difficult to draw a medium or average impression as to this man's paying qualities.

The two principal features in which improvement in mercantile-agency service is sought are a closer attention to the essential elements of reports and the institution of a bureau for the acquirement and dissemination of trade

information; and they are subjects challenging the efforts of the best talent in the agency business. The respects in which reports are susceptible to improvement are contained in the idea of a wider comprehension of the present demands of the credit department. The reporter should be schooled in the present accepted ideas of commercial credit, and the character of the reports desired is that which a competent traveling credit representative would prepare after a careful study of a case. When reports do not reach this standard the agencies suffer, and one of their principal duties is to educate their representatives in respect to current requirements.

The agencies have been urged time and again to institute a thorough system for the interchange of trade or ledger information. The fact that they have not done so may be due to the fear that the business would not prove a profitable one. The facilities possessed by the agencies for doing this work give them a marked advantage over other concerns who undertake to do it, and their services would be the more desirable on that account and would assure them of undoubted support.

One of the principles upon which credit interchange is based is that of reciprocity; in other words, if a man contributes to the fund of information upon a credit risk he should be entitled to receive some information in return for that which he has given.

There is no reason why the agencies, if they should undertake to secure trade information in the same effective way that others have, should not "make it an object to credit departments to freely confer with them and give them full facts and figures."

# CHAPTER XII

## SOURCES OF CREDIT INFORMATION—*Concluded*

### (*D*) *Credit Coöperative Methods*

CREDIT interchange is the latest significant development of credit economy. Credit interchange means the exchange between merchants of trade information and ledger experience. A large proportion of all credit information is acquired from people in business, but this particular division embraces the actual experiences of creditors with debtors in relation to the amount of purchases, the character of payments, and the creditor's estimate of the debtor, based upon actual credit transactions. This information represents the creditor's opinion of the trader based upon the character of his account and does not relate generally to the questions of antecedents, past experience in business, environment, and other matters of a local nature, as mercantile-agency information largely does.

The utilization of ledger experience has had the effect of creating a strong coöperative spirit among merchants. This has been explained in the discussion of the inability of the mercantile agencies to secure trade information with the same thoroughness and facility as coöperative agencies. There is no information more eagerly sought by credit departments nor in which credit men take a more

intense interest than ledger experience. As an auxiliary to the branches of information already discussed, there must be such thorough corroboration as will satisfy the credit man that he has exhausted every available means for the procurement of facts affecting an application for credit.

While the great benefits of this system are freely conceded, many refrain from doing their part toward perfecting it, although no one questions that the best interests of all would be served by cordial coöperation. Through it the weeding out of undesirable customers in banking and commercial circles would be effected. The dishonest man is often detected in the perpetration of his schemes by conference among those with whom he is doing business. In banking, the ability of men to borrow beyond their proper limits would be negatived by the operations of a frequent interchange among banks and others of the facts respecting the condition of accounts. The tendency on the part of people who have objects to achieve, to organize in associations or other forms of assemblies and unions, has brought forcibly to light the dependence which each must place upon the other, and the splendid results of such dependence. It has had another and equally felicitous effect, and that is to make men in business, no matter in what trade or calling they may be engaged, entertain closer and friendlier relations with each other, thus inducing expressions of that complete confidence essential to thoroughly developed and elevated business standards and morals.

The difficulty of determining accurately the reliance to be placed upon general-credit information has called credit interchange into being. It is a credit-clearance

system. Its aim is to locate the firms with which a customer is dealing; and having found them, to institute an investigation as to the standing *upon their books* of the applicant for credit. Such an investigation can be very extensive, thereby affording a mass of reliable information. It is the opinion of those engaged in credit work that there should be some substantial accessory to the mercantile-agency information. There is no better field for the establishment of such an accessory than among mercantile houses and banks. The latter are in a position to provide information of a vital character in regard to the standing of people with whom they deal. They can tell whether a man is prompt or slow in his payments, whether he shows a disposition to overbuy or to be prudent, whether his general methods indicate that he has a fair understanding of good business methods; or, on the other hand, whether he shows a tendency to sharp practice and is an unsatisfactory and troublesome customer. There is more information of this character exchanged to-day than ever before, but the volume is still relatively limited.

There is another strong reason why the interchange of credit information on the coöperative basis is necessary. The favorite method adopted by those who desire to defraud their creditors is to purchase large stocks preparatory to failing. There are other cases in which men are tempted, through ambition or a desire to recoup themselves from the losses of a poor season's business, to purchase beyond the amount that their responsibility would justify.

Overbuying, no matter what the reason behind it may be, is a great business evil. In order to avert the adverse results of overbuying there should be thorough conference regarding accounts owing or orders awaiting

shipment, as this will determine whether there has been overbuying on the part of a debtor or prospective customer.

The present coöperative methods are the outgrowth of a system of credit interchange which has existed for many years. The expression of opinions between men in regard to the commercial standing of a person constituted credit coöperation. The system of asking and exchanging references is an early feature of credit coöperation. Oral investigations by representatives of credit departments is a third feature of credit coöperation, but none of these methods is sufficiently effective unsupported by ample credit interchange. A further development of the credit coöperative theory was the organization of trade agencies from which there has developed a demand that means should be adopted for bringing into closer communication men engaged in different lines of trade under the auspices of trade bureaus governed by the merchants themselves.

There are a large number of organizations acting as mediums for the clearance of credit information; in fact, there are too many such organizations. The number concerned has naturally produced a great variety of systems. This lack of uniformity is the inevitable result of the fact that the system has had to depend for its development upon the sporadic attempts of its followers to cultivate its popularity among credit men.

A consideration of the methods of credit coöperation employed by the organizations interested in this work indicates this lack of uniformity, although the basic idea involved in all is practically the same. The work of these credit-interchange bureaus seems to be held in high esteem, and it would appear that the most satisfactory results are obtained where the work of credit interchange is car-

ried on in a certain trade. These organizations consist of credit-clearance agencies, trade bureaus organized by the people interested in the different trades, and a number of affiliated branches of the National Association of Credit Men.

The methods employed in the clearance of credit information are two: the first, a method by which ledger facts and other information are obtained through the representatives of credit departments; and the second, a method of entering information upon forms provided for that purpose, these forms being afterwards assembled and a compilation made of all the information acquired.

(1) The details of the first method are substantially as follows, this being the policy of certain credit associations: An office is established in charge of a secretary or clerk. The names of the business concerns desiring to participate are listed and a number assigned to each concern. Printed copies of this list are distributed so that each member will know his own number and also be able to identify any other concern by its number whenever the latter shall appear upon communications sent to him. The members are supposed to submit to the office a list of all their customers. A card is made out bearing the name of each customer; upon this card is also entered the numbers representing the concerns who are selling to this particular customer. As an example:

No. 1 is John Brown & Co.
No. 2 is Frank Smith & Co.
No. 3 is Richard Fox & Co.

They may all be selling Albert Stead & Co.; consequently, on Albert Stead & Co.'s card will be entered the

numbers 1, 2, 3. This indicates that John Brown & Co., Frank Smith & Co., and Richard Fox & Co. are all interested in, or selling, Albert Stead & Co. It will be assumed that Frank Smith & Co. has received an order for $500 worth of goods from Albert Stead & Co. and the latter is already owing the firm $1,000. The credit man of Frank Smith & Co. decides to investigate the general indebtedness of Albert Stead & Co. before shipping the goods. He therefore sends to the office of the credit bureau an inquiry ticket (Form 23) upon which he enters the name of Albert Stead & Co.

When this inquiry ticket is received at the office of the credit bureau the secretary or clerk refers to Albert Stead & Co.'s card and finds that Nos. 1, 2, and 3 are all interested. He therefore notifies Messrs. Frank Smith & Co. that Nos. 1 and 3 are interested. The credit department of Frank Smith & Co. has its representative call upon the firms designated as Nos. 1 and 3 to learn from them the state of their accounts with Albert Stead & Co. The investigations, therefore, whether conducted through representatives of the credit department or by telephone, are oral investigations. Investigations under this system are rarely made by correspondence unless members of the bureau are located in different cities.

It may be contended that this system has an advantage over others in that, when making investigations, many questions could be asked other than the amount owing, the method of payment, and the general opinion of the account. At the same time it should not be overlooked that if the interview be a general one there may be an absence of that entire candor that is essential to correct credit interchange.

**INQUIRY TICKET**

# Memphis Credit Men's Association

**11 North Main Street**

## INFORMATION BUREAU

**Please furnish us with local references on name below**

**Name**________________________________________

**P. O.**________________________________________

**Date**__________________190____ **No.**__________

FORM 23.—TYPE OF INQUIRY TICKET USED IN CREDIT COÖPERATIVE-BUREAU WORK.

(2) The second method of credit interchange requires that the information furnished to the bureau must be submitted in writing. This very fact is a measure of protection to those availing themselves of the information and emphasizes its reliability. The system is as follows: An office is established with a secretary or clerk in charge. The names of those who are members of the bureau are listed and numbered in very much the same manner as in the other method described. When a house desires to make an inquiry, it uses a form prepared for that purpose. A card index is used containing the names of those who have been inquired for from time to time, and on each card is entered the numbers of the houses who have made inquiries. In this way, providing that in the course of a few years every member of the bureau made inquiries on all his customers, there would be gathered by natural process exactly the same list of customers and houses interested as called for in method No. 1. It is not probable, however, that every house would, even within the time mentioned, make inquiries regarding every concern upon its books, as there are some men who preserve so unquestioned a standing that inquiries upon them are of infrequent occurrence.

Every morning the inquiry slips are assembled and the names of all the persons inquired for are entered upon report sheets; a sheet is made out for each member and delivered to him by a messenger. During the course of the day the member is supposed to enter opposite the names appearing upon the sheet statements of his experiences. A typical form used by reporting bureaus in this work is shown in Form 24. The information asked is the amount owing, the amount overdue, the manner of payment, also remarks, if the houses reporting consider it is necessary to

make any. The manner of payment is to be indicated by the symbols of a key, which appears at the upper right-hand corner of Form 24.

A question which might arise in regard to this form is whether the key representing the manner of payment is sufficiently explanatory without the addition of remarks. A key should be employed the symbols of which indicate the manner of payment and also embrace general opinions, which otherwise would have to be written at an expense of time and labor.

The "system of remarks" (Form 25) used by the Merchants' Credit Association, of San Francisco, represents a more amplified key. A messenger calls for the sheets late in the day, conveys them to the office of the credit bureau, and the information appearing upon them is compiled in the form of separate reports upon each person regarding whom an inquiry has been made. These compilations are then distributed to the inquiring houses and all other houses that have given any information. In this way reciprocity is practiced. It is also customary with some credit bureaus to send these compilations to every member on its rolls, irrespective of whether he has or has not made inquiries or given any information in regard to an inquiry.

Some houses object to belonging to credit bureaus on the ground that membership renders it *obligatory* for them to give information in answer to every inquiry. There are times when the relations of a firm with a customer are of such a character that to give the information affecting the account, exactly as it should be expressed (under the co-operative system) would reveal the existence of a very large indebtedness, with the result that the customer's

credit would be curtailed in other quarters, and the firm carrying the indebtedness deprived of its opportunities of collecting the account. The bane of "carried" or "carrying" customers has stood in the way of a more perfect development of the credit-interchange theory. Some progress has been made toward removing the objection of manufacturers, wholesalers, and jobbers to assisting in the work of the credit bureaus. In the key shown in Form 24 the letter "X" indicates "see us personally." This is a sign that the information the member has to impart is of such a character that he deems it inadvisable to place it upon the report sheet. The unwillingness of houses to freely give information in regard to accounts they are "carrying" has been overcome (through the work of the credit bureaus) by permitting them to convey the information in regard to such accounts to the person in charge of the bureau to be transmitted by him in a confidential manner (not on a general form) to the house that has made the inquiry.

The systems explained are those conducted upon a strictly coöperative basis, although they do not comprise by any means all the efforts directed to the prosecution of the credit-interchange theory. There are concerns whose special business it is to acquire trade information and disseminate it among their subscribers. Their work has been of material help in spreading the credit-interchange doctrine, and the services rendered by them have given satisfaction to many credit men. A barrier in the way of the pronounced success of an independent company doing a business in trade information is its inability to induce the acceptance of its service by a sufficiently large number of business houses to make the interchange as general as

it should be. If the clients of a credit-clearance concern are few, it follows that the trade experiences it acquires are too meager to possess any great value. The success of the credit-interchange idea depends ultimately upon the information secured and distributed being representative of an entire trade, or, in any event, of the most important houses in that trade. Only in this way will there be discovered the firms with whom the largest number of people are dealing and the character of their accounts.

The most successful work in the field of credit coöperative methods as they relate to trade information has been done by organizations instituted not for the purpose of money making, but rather to foster credit interchange. These associations are composed of business men who enter into agreements with each other to live up to the coöperative ideas upon which the organizations are based. The expense of conducting these bureaus is small, especially when compared with the fees charged by independent concerns. Men cannot be induced with any great degree of success to bind themselves by the rules of independent companies, especially when these rules provide for their giving private information into the hands of those who will market it for money-making purposes. The number of the subscribers of the largest independent credit-clearance bureau, compared with the number of those who would be expected to coöperate in such a scheme, proves the verity of the foregoing statement. It may be asked why, in the face of this opinion, so much stress has been laid upon the desirability of the old-line mercantile agencies establishing credit coöperative bureaus? In addition to the reasons already advanced it may be said that the agencies have become so intimately associated with business life that an

effort on their part to introduce the credit-interchange idea would not be regarded in the same speculative manner as the efforts of concerns which have not succeeded in making themselves a part of our business economy.

When business men organize their own credit bureaus there is no necessity for anything more than nominal, and in most cases no, capitalization. The service being voluntary does not require the supervision of more than one or two competent men to perform such executive duties as may fall to them. The question of expense is therefore a very important one and has a vital bearing upon the progress of the credit-interchange principle, for the simple reason that if the introduction of this principle of securing credit information is to be attended with a minimum cost, the willingness of commercial concerns and bankers to avail themselves of the service will be more pronounced than if the expense entailed be an onerous one. While the word "onerous" would not apply to bankers or the larger commercial institutions, it has a very decided bearing upon the ability of a large number of business houses to use this service, and the success of the system depends not upon the good will of the larger commercial institutions or bankers, but upon the universality of the support that is extended to it.

The credit-interchange system is in its infancy, and the extent to which it will grow in usefulness is dependent entirely upon the faith that is reposed in the system by business men. The trade bureaus already organized and in many cases rendering service of an eminently satisfactory character, and the many credit bureaus being formed by branches of the National Association of Credit Men, form the nucleus of a national credit-interchange bureau the

institution of which the requirements of credit reporting demand. This national bureau must be the outcome of efficient groundwork on the part of trade and local reporting bureaus. To accomplish this it is necessary that credit-reporting bureaus be established throughout the country, so that when a national organization is affected its facilities will be so thorough and its service so complete that the permanency of the system will not be a debatable question.

# PART FOUR

# CREDIT-OFFICE ADMINISTRATION

# CHAPTER XIII

## THE ANALYSIS OF CREDITS

### (*A*) *The Elements of Credit.* (*B*) *Quick and Fixed Assets*

### THE ELEMENTS OF CREDIT

In his " Introduction to the Study of Economics," Professor Bullock expresses this opinion: " It can be truthfully said . . . that the basis of modern business is confidence." It is interesting to determine on what this confidence is based. Unless it is founded upon substantial elements it is misplaced, and the exercise of misplaced confidence leads to unfortunate results. Confidence, in being the basis of modern business, also becomes the basis of credit, for *modern business* could not exist without credit.

Having exhausted every means for acquiring facts and figures in relation to the applicant for credit, the credit man must analyze this information in order to intelligently determine whether he is justified in showing his *confidence* in the risk. This confidence is based upon three different elements, viz., the reliability, the capability, and the resources of the man seeking credit or " character," " capacity," and " capital."

The task imposed upon the credit man is to determine in what degree the three elements of credit are represented

in the information before him. Credit information, if it possess that thoroughness which should characterize it, divides itself into these three elements, which comprise everything essential to the make-up of a credit risk. A man's moral principles, habits, antecedents, manners, and the estimate in which he is held by his neighbors, constitute his character; his abilities, the record of his business experience, and the special aptitude he has shown to master business difficulties, indicate his capacity; his material means or resources represent his capital. People often say, "his skill is his only capital." This use of the word "capital" is a perfectly proper one, although in the analyzation of credit information "capital" denotes the resources of the business.

While there are three elements of credit—character, capacity, and capital—it does not follow that every man either does or need possess all three. When this combination is found in a satisfactory state, the burden of the credit man is lightened and there is little hesitation on his part in granting credit. The fact that the whole combination rarely exists in a satisfactory state, makes the analysis of credit information a serious task, and demands the exercise of that skill in gauging conditions that demonstrates the ability of the credit man.

The possession of all the elements of credit is not absolutely essential to the ability of a person to secure credit. Some are granted credit on the belief in their good character and exceptional capability, although they may have little or no means. A writer has said on this point:

"A man with character and ability and no money is an anomaly in the commercial world, hence hardly worthy of our attention."

The writer referred to is not a credit man, and this no doubt accounts for the utterance of an opinion which is at variance with the everyday experience of the credit market. The fact is that nearly all the great fortunes of this country have been builded by men whose only assets when they started in life were good character and ability: the possession of these elements enabled them to secure credit favors, and thus accumulate a surplus or capital which marked the foundation of fortunes, the very magnitude of which astonishes the senses. The preaching of the doctrine contained in this quotation would be harmful in its effects upon the young if they were so ill advised as to digest any such pabulum. The acceptance of this idea would mean that there was no opportunity for anyone in this day, unless he were the possessor of sufficient means, to secure such credit as he might desire. To set up any such dictum would be to close the doors of opportunity to the poor and capable. No worse fate could possibly overtake the commercial world, for it would be left to the management of the rich only, and deprived of the influence which the character and genius of those without means would impart to it. The writer has not depended entirely upon his own views or experiences, but has sought the opinions of other credit men on the question of the relative importance of character, capacity, and capital in credit economy; and the burden of opinion strongly favors the first two as the most important elements of credit.

There are occasions when a house, having confidence in a man's character and capacity, will give him credit to start a business of his own—he has a thorough knowledge of his surroundings, the good will of the neighborhood, industry and mercantile ability, and in a large number of

instances becomes a prosperous merchant; start another man alongside of him who has plenty of capital and even good character, but little or no capacity or ability, and the chances are he will be a failure.

In discussing the different elements of credit, it should be borne in mind that a great deal depends upon the character of the business. Some lines of trade are more exacting than others, but there is no evidence that in any the man of good character and ability is barred from the benefits of credit.

Many believe that character is the foremost element of credit. This does not imply that character alone gives a man a claim to credit, but the writer does mean to say that unless a man is of good character he has no right to credit, no matter what his capital or capacity may be.

In these days, when property statements are eagerly sought, the element of character plays an intensely important part in the spirit behind the statement. The statement of a man of good character can be depended upon, but the statement of a man of bad character cannot be credited, even if confirmed by his books. He will keep dishonest books, and the latter have been known to baffle "expert accountants." Mr. William Post has said in his article on "The Loan and Credit Department":

> "Once you are sure of both integrity and ability, you will not need to give the same measure of time to verifying or dissecting the statement."

and further:

> "If you are in a mist as to integrity, pass the note."

Capacity, or ability, is a quality which does not necessarily accompany either character or capital, but one upon

which a business largely depends. Capacity gives material life to an enterprise. There must be capacity, or there will be no energy or strength to the organization. Complaint is made that too much attention is paid to capital and too little to character and capacity. Perhaps the disposition has been to overestimate the importance of capital, which, we must bear in mind, can only be utilized to positive achievement when it has capacity behind it. It is true that in thickly populated centers competition is keener than formerly, and therefore the possession of capital is more necessary in such centers than was the case fifty or even twenty-five years ago.

Capacity or personality as an element of credit, occupies a place second only to character. There are credit men who dissent from the view that character is an indispensable element of credit. It is conceded that a man who has poor business capacity will not make a success of business, but the combination of "A1 business capacity and just a little honesty," as a Chicago credit man put it, has its elements of danger. The absence of honesty or good character is harmful to the interests of not only the wholesaler or jobber who sells to the retail merchant, but the man with "a little honesty" is a menace to his own business; for while he may feel that he had better treat his creditors fairly well, on the principle that it is the *best policy* to do so, he will take advantage of those who are his patrons; sharp practice toward them will impair his business through loss of patronage; and his ability to pay his accounts and be a good steady customer of the wholesaler irreparably injured. Mr. A. C. Bartlett, in his lecture "At Wholesale," offers an excellent groundwork for a good credit, in which the elements of character and

capacity are given what appear to the writer to be their merited places.

"A successful merchant is one who grants credit with a liberality which insures the loyalty of his customers, and with a conservatism which guards against losses. To be a judge of credits means to be a judge, not only of what constitutes a good risk based upon assets and liabilities, but of human nature as well. A combination of small capital, good character and habits (business and otherwise) thrift, and industry is a much better groundwork for a line of credit to a customer than is large capital, indifferent character and habits, and loose, unbusinesslike methods. It goes without saying that adequate capital, unimpeachable integrity, and strict business methods constitute the ideal risk."

Capital represents the money or means employed in the business. In the case of a man beginning business in an humble way, within the means at his disposal, and reënforced by character and capacity, capital is not, and should not be, a determining factor.

When, however, a house which is organized on a pretentious basis, with a large staff of employees and a big expense account, seeks extensive lines of credit, then it is certain that unless that concern has within itself the required capital or means of accommodation adequate to carry it successfully until such time as it can increase its capital, the omission to give to the capital element a primal place in the consideration of the credit would probably result in a loss to the creditor.

Some credit men (although a minority) are of the opinion that the leading elements of credit are capacity and capital. In support of this contention the advocates of this combination hold that the statistics of failures prove that the greatest number of failures come from "lack of cap-

ital" and the next largest number arise from "incompetency" or "incapacity." This opinion has been expressed by different credit men, and was also set forth in a recent work on credit. The figures published by The Bradstreet Company for 1904 show that in the United States the percentage of failures due to "lack of capital" was 32.2 and to "incompetence" 23.1, making 55.3 of the entire number of failures attributable to these causes. In Canada, during 1904, the percentage from these two causes amounted to 76.4. This would seem to be a strong argument in favor of the "capacity and capital" platform, but the evidence of the figures is not conclusive without an exhibit of the lines of business in which these failures due to "lack of capital" and "incompetence" arose. The tables of The Bradstreet Company also show that the great mass of all the failures in the United States and Canada were among those who had less than $5,000 liabilities; also that over ninety per cent of those failing were rated at $5,000 or less. This indicates that the largest percentage of failures takes place among those who have little if any capital, or the small dealers.

That so large a percentage of failures takes place among those of very small means does not indicate that it is necessarily "*lack of capital!*" The small trader is in a good many cases one who is willing to put a little money into a business venture, trusting that it may be a success, and then when he is not able to acquire as good a living as he expects, abandons the business entirely. These small people cannot be judged by the same standards of competency as the larger traders, and it is rather difficult to decide just how far he is affected by "lack of capital" or "incompetence"; as already stated, the figures are not

conclusive in establishing the soundness of the premises as to the place of capacity and capital in credit, without certain knowledge as to the lines of trade in which the failures under discussion occur. For instance, it is rather difficult to decide where a saloon keeper's competence or incompetence begins or ends; his lack of capital may be, and in a good many cases is, the lack of willingness on the part of his brewer to run the enterprise any longer, for the actual capital put into such a business by the man who runs it is very, very small.

Another question which arises here: Although so large a percentage of the failures occurs in the classes rated $5,000 or less, it would be interesting to know just what percentage this bears to the whole number of people who are *rated* $5,000 or less; remember that the total number of people in business in 1904 in the United States and Canada, according to The Bradstreet Company, was 1,418,361, and the number failing rated $5,000 or less, 10,488. As 55.3 per cent of all the failures were due to "lack of capital" and "incompetence," the number of those rated below $5,000 whose failure is to be attributed to these causes is 5,799. The writer ventures the opinion that this number (5,799) represents an infinitesimal fraction of the whole number of people in business during 1904 who were rated $5,000 or less, and it is a comparison of this whole number with the number of those who failed because of these reasons (5,799) which would indicate how far the principle of trusting in men because of their character and capacity and with little respect to their capital, has proved a salutary one.

The ideal credit risk, ideal in the sense that all ordinary dangers are eliminated, is that in which the three

elements of credit—character, capacity, and capital—are all represented. A good risk is one in which character and capacity may alone be represented, for good character furnishes a moral guarantee that the interests of the creditor will be respected; and the capacity or ability will insure good management and its result a paying and successful business. A doubtful risk is one in which character and capital only are found, as the absence of capacity negatives the probability of success. Another doubtful risk is one in which capacity and capital alone appear, as the moral safeguard is missing and the creditor is left entirely at the mercy of the debtor. In risks where character, capacity, or capital figure singly, there is little basis for credit; as either one, unsupported, offers no groundwork for a sustained business career. This opinion may be questioned in the belief that if a man starts a business with ample capital, but with neither good character nor ability, he would be able to pay for his goods because he would have the capital or funds with which to do it. He would for a time, so long as his money held out. After that he would be reduced to measures which would undoubtedly prove prejudicial to those crediting him. Therefore, wise credits depend upon a proper recognition in their respective places of character, capacity, and capital.

## QUICK AND FIXED ASSETS

In order that credit be wisely dispensed, it is necessary that the assets be accurately appraised and computed, and their composition be clearly understood by the credit man. It is not sufficient that a man submit a property statement showing the possession of a large amount of stock, and

other assets, but that those assets should be of a nature that will make them a real help to the business and not a drawback to it. The effect of the composition of a man's assets upon his paying qualities is one of the most important questions demanding the consideration of the credit man. If a man be overstocked he will be slow in his payments—a fact to which the credit man should give due weight before either opening an account or continuing one in which he may be interested. Further, where traders turn their capital which should all be employed in the business into different channels, such as outside investments, real estate, and unproductive accessories to their regular business, such assets as would be represented under these heads must be very carefully analyzed and their actual value only computed in estimating a man's credit desirability.

It is evident to all who have taken a deep interest in the progress of credit economy that the question of the nature of assets has not been given due prominence in the discussions of credit problems. Both creditors and debtors have erred in this regard, neither having given to the subject that thoughtful attention which would probably have saved many serious losses in times past. The debtor's propensity is to estimate at full value everything of which he is possessed, and creditors have been too much inclined to accept at their face offering the items of property statements.

The assets of a business are of two classes: Live or Quick Assets and Slow or Fixed Assets. The first class consists of that character of property for which there is a steady demand, or for which under all ordinary circumstances there is a ready market; or property which can

be converted into money or utilized for credit purposes on short notice. Such assets are represented by cash, marketable merchandise, good book accounts, securities, and any other character of personal property subject to expeditious sale. Slow or fixed assets are those for which there is not a ready sale, especially such property as is not of constant utilization in the course of the business. They consist of furniture and store fixtures, buildings, real estate, and machinery, and investments which are of a developmental or speculative nature.

In analyzing a property statement the credit man must make a division between quick and slow assets. A conservative estimate should then be placed upon these two classes of property, in order to determine approximately upon how much *active capital* the business can depend.

The question which now presents itself is: To what extent, if any, should slow assets be considered in estimating a man's credit responsibility? Are they entitled to any consideration or not, or are they only to be relied upon as giving a modified measure of support to the business? There does not appear to be a unanimity of sentiment on this subject among credit men; in fact, the same differences of opinion have arisen that seem to appear in respect to almost every matter concerning the dispensation of credit. It is necessary, therefore, to understand how this question appeals to credit men, before entering upon the expression of any positive opinions in regard to it.

The views of credit men on this question may be summarized as follows:

1. Some believe that slow or fixed assets should be entirely eliminated from all calculations in estimating a man's credit worth.

2. Certain credit men hold that a separation of all assets should be made into the two classes, and the slow or fixed assets scaled fifty per cent and then regarded as a matter of security only for the other elements of the business.

3. It is also held that slow or fixed assets must be considered in deciding on a man's responsibility, as they are an undoubted help and sometimes a real salvation if a business has to be liquidated.

4. If slow or fixed assets are not of sufficient volume to impair a man's ability to secure a proper and easy revolution of his capital, they are a positive help, especially with liquidation in view.

5. If the slow assets represent only a moderate percentage of the entire capital, they are in no sense a detriment, but are an element of strength.

It will be observed that as to views numbered two, three, four, and five, the sentiment differs in form but not in principle. The opinion numbered one, however, draws the line of cleavage very sharply and does indicate a decided difference in principle from the other opinions quoted. It is questionable whether the idea of eliminating all fixed assets from the consideration of a man's credit responsibility could be rigidly followed without making a radical reduction in a firm's sales; and the great merit of credit-giving is to employ care and conservatism, at the same time making a constant and judicious increase in the yearly sales. The plan of elimination suggested could be and no doubt is employed by banks, or when the concern applying for the credit is a large one and the amount of credit sought relatively large. It is probable that this plan is intended to apply to such cases. Used in respect

to the smaller class of traders, it might have a tendency to unduly restrict credit, and this is something that all farseeing credit men desire to avoid. It is probable that in ninety per cent of the cases in which credit is granted, credit men look to slow or fixed assets as a mainstay of the business, or, as one credit man has expressed it:

"The fixed assets of a concern (such as real estate, buildings, store property on long lease at low rental if of sufficient volume and properly protected by insurance) we look upon very favorably or as the sheet anchor of the risk, because it is largely this on the final wind up that prevents ultimate loss."

In the event of backward trade or a business depression, a man who has transferred his ready capital into real estate or outside ventures finds himself at a great disadvantage. In good times, in certain localities, a piece of real estate can be disposed of as quickly almost as any other character of property, but this is the exception and not the rule, unless sacrificed. Very often a merchant will go to a large outlay improving his premises, putting in costly fixtures, and to do so has to use capital which should not be withdrawn from the business. In addition, improvements of this nature, while they may be helpful in some lines of business for advertising purposes, shrink in value with time and are of no assistance whatever as a means of securing credit accommodation, especially at a time when it is most sorely needed.

The tendency to turn one's capital from live to slow assets is attended with more danger in some lines of trade than in others. In a business where goods must be bought on short time and prompt payments exacted, the merchant must have all available capital constantly at his

command; in such a business an undue proportion of slow to live assets is an unerring warning to the credit man. In lines of trade where goods are sold on long time, the presence of slow assets is not as decided a disadvantage, but one to which proper significance should be attached. Credit men have found from experience that certain slow or fixed assets have been the means of averting serious losses from bad debts when a concern is insolvent or forced for other reasons to liquidate. It would have been much better, however, if the merchant who has been unfortunate had kept all his capital in such a form that he could have continually utilized it in his business, and in this way no doubt avoided a failure. The loss to business by a man's failure is twofold: that which he and his creditors sustain and the loss which commerce and trade suffer by the elimination of the merchant as a business factor.

# CHAPTER XIV

## METHODS FOR SAFEGUARDING CREDITS

*(A) General Expenses with Special Reference to Rent. (B) "Credit Lines and Limitations." (C) Fire Insurance and Its Relation to Credit. (D) Comparative Statement Forms*

### GENERAL EXPENSES WITH SPECIAL REFERENCE TO RENT

Among the questions which must be studied in the consideration of a man's credit responsibility is his method of management, especially as it affects the expense of conducting the business.

Economy in management is quite as essential to the success of a business as general efficiency; in fact, economy is a feature of efficient control. Extravagance or loose management is destructive to the successful conduct of a business. The general expenses of a business are usually rent, light, heat, clerk hire, advertising, insurance, and many smaller items of outlay or "sundry expenses." These are the fixed charges of a business without which it cannot be prosecuted. It is customary to insert in property-statement forms the question: "What are your annual expenses?" or a better question and one also largely used, "State amount of expenses last year."

Some credit men consider that where a large amount of credit is at stake they should have an itemized list of the expenses a merchant has incurred during the preceding year. There are excellent reasons why this should be done, although to exact such a list in a great many cases might have a tendency to irritate the man giving the statement.

The danger of exciting the resentment of the trader by asking him to give a statement of his affairs, and the desire to cater to his prejudices, has resulted in the use of statement forms that are altogether too brief to form "an adequate foundation for a liberal credit," and the doubt created by a general statement of the gross amount of annual expenses should be avoided by demanding an itemized list of expenses. Where the amount of credit sought is trifling, the necessity for such detail does not exist; but when the credit man feels that the amount involved justifies his insisting upon an itemized list of yearly expenses, he is remiss if he does not demand it.

Although most property statements do not call for an itemized list of annual expenses, some ask, "What amount of rental is paid?"

Unquestionably, rent is looked upon as a matter of more than ordinary importance, otherwise questions in regard to it would not appear in property statements. Notwithstanding the prominence given to this question in statement forms, it is one respecting which there has been little public discussion as related to the problem of credits. There is general agreement on this point: viz., that the question of rental is not affected or should not be affected by the capital employed or the volume of business transacted, but that it is more generally

based upon the profits which may be derived from the business.

Mr. Samuel J. Kline, of Chicago, shows that the basis of rental depends very largely upon the nature of the business, as follows:

> "It will therefore be seen that the signing of a lease for a term of years is a matter which should receive most careful consideration. Naturally, like any other form of expense, the rental should bear a well-defined relation to the sales, or, to be more exact, to the *gross profits.* We make this distinction between sales and gross profits because some lines yield a very much greater percentage of profit than others; for instance, a drug store located on some prominent corner might with perfect safety pay a very much larger percentage of its sales as rental than could be paid by almost any other branch of business, but the *relation of the rent to the gross profits should in every line be approximately the same.*"

The foregoing expresses the general trend of opinion in regard to this subject.

It is obvious that one of the most important elements affecting the question of rental is that of location. Different lines of business require different characters of location; for instance, a jobbing or wholesale establishment in certain lines need not be located on the best business street, for the reason that the rental in such a location would be higher than the purposes of the business necessitate. A large percentage of the business transacted by wholesale and jobbing concerns is done by their traveling representatives, and patrons do not find it absolutely necessary to visit houses from whom they make purchases; neither is it necessary to display goods as in the retail business; consequently, the importance of the location is minimized. It is necessary that a house in any trade be

located where it will be convenient for its patrons and the general transaction of its business.

There is a radical variation of opinion as to the ratio which rental should bear to the gross expenses, estimates running all the way from one per cent to seven per cent of the business done. How far these percentages accurately reflect conditions as shown in property statements it is impossible to say. Mr. F. H. McAdow, of the Staver Carriage Co., Chicago, has made an analysis of certain statements in his credit files, which he has placed at the disposal of the writer, and the results of this examination are as follows:

"Judging from the answers given on the statements I have been looking over, a rental of $300 per annum seems to be the average for sales running from $6,000 to $15,000. It is rather surprising to note the variation. One firm in a small town pays $15 per month, or $180 per annum, on a business of $7,000 annually. Another man in a still smaller town pays $180 per annum and does $13,000 worth of business a year. In another case a dealer pays $1,200 per annum rental and is doing a business of from $20,000 to $25,000 per annum. This man, however, is not very successful, as his indebtedness indicates, although he has been in business for a long time. As an indication of what it costs a firm when they own their own property, I note in one case where the store building and lot are valued at $4,500, while the dealer does a business amounting to $6,000 annually. He would have to figure interest, indebtedness, taxes and betterments on his property at about eight per cent, so he is paying $360 per annum, or six per cent of his gross sales, which is considerably higher than the average. So when we consider the fact that in these times dealers cannot figure a gross profit of more than fifteen per cent or twenty per cent on their gross sales, if they are to make a reasonable net profit on their capital invested they must keep their expenses down and leave a safe percentage. A conservative percentage to allow for rent would be from three per cent to five per cent of the annual business, or

gross sales. By the time other necessary expenses are added to this as a starting point, the profit will be small enough. From the property statements I have looked over in our files, I believe the average would be about four per cent."

One of the interesting facts to be derived from the foregoing is that two men engaged in the same business are paying the same amount of annual rental, although one is doing twice as much business as the other. This may be, however, no reflection upon the judgment of the man who is doing the smaller business, for the town in which he lives may be one in which general real estate valuations are much higher than in the other, and it may be impossible for him to secure any lower rental than that which he is paying. The only conclusion deducible from this condition, however, is that the man who is doing the larger business is in the enjoyment of a great advantage, for which local conditions are entirely responsible.

Mr. McAdow says the average would be about four per cent, and the only method of determining whether this average is a justifiable one would be to submit the question to the test proposed by Mr. Charles Biggs, of New York, viz., "to ascertain the usual rental for a given amount of space and which is essential to the successful prosecution of the business."

It is evident from opinions expressed that some credit men do not regard the question of rental or any other item that enters into the general expense of a business as being of a nature to warrant any special analysis; some inclining to the idea that the matter of rental is one which must of necessity be left to the judgment of the merchant; or, on the other hand, that a man should not hamper himself by paying small rent in an undesirable location if

he considers that the prospects of doing a successful business will be enhanced by removing to a location where the rental may be much higher; this being in harmony with the general consensus of opinion on this question.

Certain States have laws which give a landlord a preference covering the amount of rental due him, or the amount which would become due during the full term of a lease, and cases could be cited where the operation of such laws have consumed the entire estate. Under the National Bankruptcy Act, preferences of this character cannot be enforced; but if at any time that act should be repealed and the country return to the State system, the question of rental would become a more important one than it is ordinarily supposed to be, and more attention would have to be given to it than in the past.

The amount which a man is paying for rental, if it be of sufficient importance to be made a matter of special inquiry in a property-statement blank, should also be a matter of careful investigation on the part of credit men. No good purpose can be served by asking the question, unless, after it is answered, the credit man satisfies himself that the rental being paid is proper. The guide to a correct determination of this question, as indicated by Mr. Biggs and explained in the other opinions cited, can be used with profit by credit men in order that tendencies on the part of those applying for credit to indulge in unnecessary expenses may be checked.

## "CREDIT LINES AND LIMITATIONS"

In the consideration of the methods of banking credit departments, attention was called to the question of discount lines or stated amounts that a bank would be will-

ing to lend to a customer from time to time, and which a customer could rely upon receiving whenever he found it necessary to ask accommodation. It was also shown that there is no definite rule for determining what a customer's credit limit shall be. In commercial credit there is supposed to be some definite "line" or amount of credit that a house is willing to accord to a customer. The method of deciding as to what such lines shall be, or adhering to them, seems to be a matter of as much random reasoning and practice as the assignment of discount lines in banking. There always has been a sentiment among credit men in favor of according to each customer (and marking on his account in some way) a certain figure representing the limit of credit which they believe should be granted to him.

The credit line or limit of credit was probably instituted as a danger signal for credit men, and if this be the only purpose it has served, it has fulfilled its mission. The difficulty with the idea is that in selecting the lines or limits there has been no explicit rule followed. Even in the same trade two credit men, when according a line to the same customer, will assign entirely different amounts to him. The variation in these limits may reflect the disparity in temperament of the respective credit men, but if their views be radically dissimilar it shows that there is not that general agreement as to credit usages that should exist.

Consultation with credit men reveals this situation: It is the rule of certain concerns to fix limits on all accounts, but no pretense is made to adhering to them. Others consider that credit lines are useful only in the cases of financially weak customers, so that if accounts

are not paid promptly, a halt may be called and further credit denied. Others claim to use credit lines as a precautionary measure, so that the bookkeeper may call attention to an account when the line of credit has been reached. Still others think that credit lines are necessary in the case of first purchases only, and that any subsequent accounts should be judged on their merits. In some credit departments credit lines are used only on small accounts. It is also found that many credit men do not use credit lines at all, and consider them of no value; the belief of this class being that every purchase should be considered in order that credit be safely extended, for only through this method will the changing conditions in the circumstances of debtors be given the attention that each development deserves, whether it be for good or ill.

In some trades credit men say they find it inadvisable to assign credit lines, for the reason that if a man's responsibility is not such that they can afford to sell him all he will require during a season, they can hardly afford to deal with him at all. In such cases a man's limit of credit is measured by his requirements, although it is well understood that such requirements will be predicated upon his resources and general credit standing, whatever they may be. After all has been said, the fact remains that the utility of credit lines is not universally recognized, and there is apparently no scientific basis of calculation for the determination of such lines.

The most effective method of reaching an understanding as to the views of those who believe in and those who are opposed to the use of limits of credit, would be to take the opinions of practical credit men representing the affirmative and negative of this subject. The opinions quoted

are thorough in their analysis of the different phases of this question and exhibit ideas prevailing in two of the staple lines, viz., the grocery and dry goods trades. The first opinion is that of a credit man of one of the largest grocery concerns in the Middle West, and is as follows:

"For convenience and office reference, a nominal line of credit is assigned to customers on credit index cards but not closely adhered to. This line of credit is generally figured at about ten or fifteen per cent of the net trade assets of our customers which represents their reasonable requirements; in other words, a dealer in our line, with a $2,000 investment ordinarily requires a $200 to $300 line of credit. He might have $10,000 outside property, making him safe for much larger amounts, but our index record is noted for his *reasonable requirements* only on amount of stock carried and business done. On the other hand, a customer, in whom we have implicit reliance as to honesty, ability and prospects, with a net worth of $1,000 to $2,000, giving us his entire business, will often receive a line of $1,000 to $2,000 credit, or as much as he is actually worth and this may not represent more than thirty days' purchases, as an active retail grocer will often turn his stock in from three to five weeks and in selling for cash, or with careful credit in connection with other favorable conditions, will be *reasonably* safe for liberal lines. I always avoid giving a customer or salesman to understand that a certain line of credit will be extended as with changing conditions, a line that is safe to-day in a few months may be dangerous, and, therefore, being handicapped by promises salesmen frequently make to customers, that the house will carry them for such and such amounts. Customers will often abuse such privileges and understanding that we will grant them certain lines, will lean more heavily upon our good will than they should or relax necessary care in their credits and collections. Again, a customer from all information may be entitled to a $1,000 line of credit and owing only $200 or $300, but this several weeks or months overdue. Notwithstanding the supposed safety of the risk, I would not increase the account until delinquent matters had been adjusted or satisfactorily explained. You will, therefore, notice that the line

of credit I assign is by no means absolute nor closely adhered to; but simply used as a convenient reference for assistants or other employees to whom, in emergencies, it may be necessary to refer orders. I understand some jobbers enter a line of credit on the ledger page of each customer which is adhered to closely and bookkeepers allowed to pass orders as long as the account does not exceed the stated line, or is badly in arrears. In that way a small percentage only of orders is actually passed upon by the Credit Manager or his Assistants, but handled by bookkeepers. I do not believe such practice is general, though some prominent houses adopt it, but I am confident no credit man can successfully keep in touch with his accounts without, in a general way, watching the individual orders and remittances from customers as well, in connection with examining daily or weekly statements of maturing bills, or semimonthly or monthly delinquent statements. In our office the credits are classified to a large extent by territories, four or five of my assistants handling the details and passing on a large percentage of orders, referring to me only those that are doubtful, but, by a system of cards, drawn once, twice or three times a month from accounts that are watched closely, and also a cursory glance of statements mailed and remittances received, I can, as a rule, easily keep informed of the condition of dangerous accounts which, as you understand, are the ones that require attention, the safe credits generally taking care of themselves. Our bookkeepers also become familiar with requirements and call my special attention to accounts that are dragging unreasonably."

The foregoing opinion, while mainly favorable to the use of credit lines, also shows the difficulties encountered in depending on them; in fact, while it upholds this method in credit work, its opening statement is an admission that the lines are not respected. The basis for the establishment of these lines, viz., ten to fifteen per cent of the quick assets of a business, is a conservative one. At the same time, it will be noticed how radically the views of the credit man change when he has an oppor-

tunity to secure what he considers the entire trade of the purchaser. This disposition to extend so large a line of credit is justified by the fact that the goods are sold on short terms and purchases are frequently made, both of which conditions enable a house to maintain closer and better relations with a customer than when goods are sold on long time and purchases are made only occasionally.

Even where lines of credit are supposed to be a guiding rule of the credit department, the point is excellently taken by the credit man quoted, that he is not in the habit of giving the customer to understand that a definite amount of credit will be allowed, for everyone who has had experience with people who buy on credit can appreciate the argument made by him. The propensity of credit seekers is usually to take advantage of almost every condition that suggests itself, if encouraged or permitted by the creditor to do so. The wisdom of using a credit line is approved by the policy of the credit man whose work is under discussion, when he says that where an account is overdue he would not consent to increasing it in any way until the tardiness has been overcome.

The danger is also suggested of according to bookkeepers and subordinates in the credit office the privilege of passing on accounts with lines of credit as their guides. A custom of this character is apt to divorce the credit man's close attention and interest from a large proportion of the accounts, and this will surely be attended by a slackening of that studious application to the duties of his position that is essential to wise credit giving. There should be no disposition to alienate the bookkeeper's interest from credit matters, for he can be of great help to the

credit man; but to assign to bookkeepers the duty of checking a large number of orders that must be passed upon in a business is really creating a division not only of the labor, but also of the responsibility that attaches to the credit office. The inevitable result is that "an interest divided is an interest lessened," so far as the efficiency of the credit department itself is concerned.

The other opinion to which reference has been made, and which will now be quoted, comes from a representative dry goods house of the Middle West:

"I have been trying for over twenty years to learn how to assign a line of credit to an account and adhere to it, but have been unable to do so for the reason that the conditions surrounding each account are continually changing. For instance, a man might come in our office to-day and make a statement of his financial condition which we would find to be correct. We would convince ourselves he was honest and a man of ability and that he would be careful in the conduct of his business. He might start out with the idea of doing a cash business, as the location was in a prosperous country. In six months he might with good reason decide to do a credit business. Crop conditions which were perfect at the time the business was started change to the contrary, as is often the case in the territory in which we do a large portion of our business. The number of stores in the town in which he started may have been just sufficient or not quite as many as the town could stand, while in the interval of six months others might open, and business be overdone. Originally competition might be clean and legitimate while during the interval mentioned some competitors might have contracted the scheme of 'kiteing,' or, in other words, use questionable methods to obtain business which temporarily might cripple him. He might start in a locality where there was no other trading point within ten or fifteen miles, while in six months there might be new towns started which would divide the trade. We have just gone through an experience where hail has caused a great deal of havoc in a very small scope of territory and practically puts our customers out of

**business or at least forces them into an extensive credit business for the time being."**

The credit man who wrote this opinion is unquestionably right when he says that the changing conditions that are constantly entering into the life of an account disparage the possibility of establishing any hard and fast lines or limitations. The reasons he offers for doubting the expediency of using these lines are all worthy of careful consideration. The fact of a customer changing his business from a cash to a credit basis, unfavorable crop conditions, unfair competition, and damage from the elements, all constitute good reasons for holding that absolute adherence to credit lines is impossible.

The point to be debated, and one which readily suggests itself from the large number of varying opinions, is whether credit lines or limitations do not answer a useful purpose and are not of considerable value to the credit man in the prosecution of his work. It is undoubtedly true that no matter whether a credit man marks a line of credit upon the ledger account or keeps it upon a credit reference card or uses it in connection with any other office records, he always has in his own mind an idea as to the amount of credit he would be willing to grant to every person with whom he is doing business. It is indubitable that after a credit man has considered the information he has acquired in regard to an account, if he will sell to the person at all, there immediately springs into his mind a thought as to about the amount he would be willing that person should owe to his concern. It is this mental record or reservation which is the inherent guide of the credit man in his treatment of accounts. But even while he carries within his own mind an idea

as to the amount the customer should owe at any one time, it is of benefit to him to make a record of the amount beyond which he believes the account should not go. Again, where a credit man is compelled for different reasons to absent himself, whether through illness or any other reason, it is not a good idea that there should be no record left by him as to how the different accounts should be handled. Where he has placed a line of credit against accounts, it is reasonable to suppose that these lines are within the safety mark. During his absence there is little danger of an unsatisfactory account being added to, providing his credit information is recorded with promptitude and is subject to ready reference. While conceding the impracticability of credit lines being inviolably respected, it will not be denied that in many instances they are of great advantage; and until some better method of governing this question can be devised they will undoubtedly continue to be an element of credit office administration.

### FIRE INSURANCE AND ITS RELATION TO CREDIT

In addition to desiring that a customer shall be a person of good character, with sufficient capacity to conduct the business, and also the reasonable capital required for its prosecution, the credit man finds it necessary to assure himself against the possibility of losses arising through causes that may be wholly beyond the control of the customer. A man may be doing a successful business, but in the event of his property being destroyed by fire, his failure to carry a sufficient amount of fire insurance might render it impossible for him to discharge his indebtedness in full.

It is customary when a man is applying for credit to ask him orally whether he is insured and what amount of insurance he carries, or if the opportunity to consult with him directly is not afforded, to insist upon his answering this question in some form, and preferably when he is making a statement of his affairs. For this reason, in every well-prepared property statement there is an inquiry as to whether or not the person making the statement carries fire insurance and to what extent. When the credit man learns how much insurance is being carried by the customer, or prospective customer, he is not in doubt as to whether, in the event of fire, that person should be in a position to discharge his indebtedness without injury to his creditors, always providing that the statement as to the insurance being carried is an honest one, and further, that the insurance has been obtained from companies that are solvent and will be able to pay losses when called upon to do so.

No business man could undertake a risk more fraught with danger than to dispense credit among those who are carrying no fire insurance, for the elements of good character and business capacity would be of no avail in preventing a loss under such conditions, and it would only be the existence of ample capital that would prove efficacious in preventing a loss under such circumstances. In the great mass of business enterprises the capital invested represents the merchant's all, and it is rarely that a merchant uninsured, who suffers a fire loss, is able to discharge his indebtedness in full.

It is necessary that a merchant should be insured and for a sufficient amount. Where he overlooks his interests by failing to carry insurance, it is the credit man's

duty to his house as well as to his patrons to express a kindly word of advice upon this point. In a series of articles published by the National Association of Credit Men on the question of "Fire Insurance an Essential to Credit," several cases from actual experience are quoted, showing that the thoughtfulness of credit men in this respect has prompted the merchant to increase his insurance, and thus saved his creditors and himself from a serious loss. In the series of articles mentioned is one by Mr. George R. Barclay, Vice President of the Simmons Hardware Co. of St. Louis, in which he says:

"The Simmons Hardware Co. has for several years past issued to its traveling men instructions about the close of the year to interview their trade regarding the matter of insurance, ascertain the amount carried, etc. This information is placed on record in our Credit Department, and where we find our customers are without insurance, we bring the matter to their attention in a way to cause no offense, and feel sure we have influenced a great many retail merchants to avail themselves of the protection offered by insurance companies."

The plan followed by the concern mentioned affords an excellent example to all other houses, and where a concern is not in a position to communicate with its customers through the medium of traveling salesmen, methods can be devised to accomplish the same result through correspondence.

## COMPARATIVE-STATEMENT FORMS

The purposes and advantages of comparative statements in banking credit have been explained; and the same reasons that would recommend the use of comparative-statement forms in banking-credit departments should

also promote their use in commercial credit offices. The use of the comparative-statement form is a banking custom more than a commercial one. Credit men of commercial establishments who have had banking experience and through it acquired the habit of using a comparative-statement form, employ it and are of the opinion that the results of its use fully justify the extra labor entailed.

Some credit men have expressed the opinion that when they receive a new statement from a customer and compare it with the last statement received from him, and consider the results of the comparison, this method satisfies all requirements. This plan, however, involves what would be called a mental comparison and cannot be as effectual as the method by which figures are properly tabulated, and can be referred to at any time during a year without the necessity of turning over a great many papers and making a computation to decide exactly what the results of the comparison may be.

The principal reason that has operated against the use of comparative-statement forms in commercial credit is that merchants are not in the habit of demanding statements from customers with the same regularity that banks follow the practice. Further, in many cases a customer will refuse to fill out a statement form sent him by a wholesaler or jobber, but is perfectly willing to send a statement prepared in his own way (very often on a letter head), and the recipient feels that this is the best he can get. He accepts it in that spirit and hardly thinks it worth while to make any tabulation of the facts contained in such a statement, although such conditions do not disparage the use of a comparative-statement form. Another reason, and probably the strongest one, that has prevented the use of comparative

statements by commercial credit men is that they would have to be filled out by some one in the credit office, and the fact is that the time of the credit man and his assistants is usually preoccupied with what might be called the regular work. As the comparative statement has not up to this time taken a very prominent place in credit office work, the avoidance of this and any other duty that does not seem to be absolutely pressing, readily approves itself to the credit man. Although the preparation of a comparative statement means a little extra work at the time each property statement is received, the advantage of having on one form all the essential details of every statement a man has submitted to his creditor for a number of years is one that credit men can hardly afford to overlook.

# CHAPTER XV

## THE CREDIT MAN: DUTIES, METHODS, AND CHARACTERISTICS

THE duties of the credit man pertain to the acquirement of information respecting the credit standing of people, the consideration of the questions that determine a person's credit desirability, credit office management, the collection of accounts, and the adjustment of doubtful and failed accounts.

In some large establishments the credit man takes charge of credits only, the collection of accounts being supervised by others. This division of labor is at times necessary, for the reason that the credit man, having so many accounts upon which to pass, would not have the requisite time to give to the questions of collections and adjustments. In other concerns the credit man is supposed to discharge all the duties enumerated and also to take charge of the accounting department. If this does not conflict with his giving the necessary attention to his distinctively credit duties, it is in no sense a detriment but greatly to his advantage, as it broadens his experience. The greater familiarity a credit man cultivates with all branches of a business the better for him. This experience is something that he will have reason to prize in after life.

The labors of the credit man which postdate the opening of an account call for a high order of ability. He must

exhibit that power of observation enabling him to review accounts with the knowledge and foresight so essential to the conduct of well-regulated credits. His hardest work has then begun. The means that he adopts depend to a great extent upon his own originality and industry. He should never miss an opportunity to consult with the salesmen to learn from them whether their customers are progressing or retrogressing. The credit man may also secure information by discussing his customers with other credit men or private persons. Such discussion should be conducted in a diplomatic manner and never initiated in what would appear to be a spirit of anxiety. He should also make prompt and regular examinations of the change lists issued by the mercantile agencies or reporting concerns. Very often important developments in credit work have the merest rumors or scraps of information as their foundation, and the credit man who can utilize this character of information, no matter how trivial it may be, is the one who possesses the instinctive capacity for credit work.

System is one of the most important factors in business management, and there is no department of business life where it is more necessary than in credit work. There are so many details in credit work that the credit man is liable to stand in his own light unless he arranges and dispatches his duties with systematic precision.

The credit man's habits should be steady, which is a concession to system; it would be well for him to have regular hours during which he would consider certain branches of his work; for instance, to give the first part of his day to consulting the morning mail, then to consider orders and applications for credit—this business demands prompt attention and cannot be side-tracked—he may then

turn to his correspondence, after this take up the question of collections, and so on, so that he would not only become accustomed to the routine, but that others may know the best times to approach him without unduly interfering with his duties. This programme is a mere suggestion, but its application, either in modified or amplified form, would be of assistance to the credit man in establishing a reputation for systematic management that every good business man desires to possess.

## CREDIT OFFICE MECHANICS

The duties of the credit office include the arrangement and preservation of credit information. It is important that the records be promptly filed in order that they may be in convenient form for reference. It would be useless to attempt to prescribe any single plan for the filing of credit information, as the ideas of credit men on this subject are extremely varying. No particular principle is involved and consequently the credit man avails himself of the devices that are most pleasing to his fancy. The end desired is to provide a system demanding the least possible labor and at the same time conducing to quick action whenever it is necessary to refer to these papers.

## CREDIT REFERENCE CARDS

The crux of good credit work lies in the ability of the credit man to handle a larger amount of sales each year and reduce the average of losses from bad debts. Any man can avoid making bad debts if he desires to do so; in other words, he can attain this result by arbitrarily eliminating every account excepting those of undoubted standing. This policy, if followed, would mean that the sales of a

house might be reduced to such an extent as to impair the possibility of profit-making. There is a very large percentage of trade that must be done with people whose responsibility is not the highest, and the great percentage of them are safe debtors; there is still another class looked upon as of doubtful responsibility, and even many of them manage to pay their accounts within a reasonable time, although it is in these two classes that the element of risk largely prevails. Mr. Cannon, in his paper on "Credit, Credit Man, and Creditor," says on this point:

"It is not a question of how many goods can be sold, but what volume of business can be transacted with only minimum losses from bad debts, and how sales can be increased each year, with a decrease in the percentage of losses."

The number of accounts handled by the larger concerns in the staple lines has become so great that it is an impossibility for a credit man to remember all the essential facts relating to each account. If his memory be good, he may be able to retain a general idea as to the status of each account; still, there are so many details involved that if he attempts to treat them all from memory, he will overtax himself. In order to obviate this difficulty the card-index system has been employed to provide the credit man on short notice with the status of each account. He can use these cards either in interviews or in handling collections or general correspondence. The credit man of one of the largest industrial corporations has given the writer the following description of his method. It is a very interesting illustration of the method and its utility:

"We use a large filing case containing folders, placed vertically, and numbered from 1 upward, each representing some customer, or prospective customer. An index book gives the number of the

folder opposite the customer's name. Each folder contains all the information that we have been able to secure concerning the credit status of the customer, including correspondence appertaining to the account, which might in future shed some light upon our business relations.

"In conjunction with this, we have a card system for the purpose of ready reference, which, aside from being very convenient, we have found almost a necessity. There is a card for each customer, bearing on its face a number to correspond with that of the folder, and also the name, address, business, ratings, terms, and expiration and tonnage of the contract. On the reverse of the card is a digest of the information at our command in regard to the customer. This illustration shows a specimen card, picked out at random, a fictitious name being substituted.

No. 305.
NAME—JOHN DOE PUBLISHING CO.
ADDRESS—Doeville; B. J.
BUSINESS—Pubs. 'Morning Screecher.'
RATINGS— TERMS! Net 30 days.
B. 35M-50—M1st July, 1905.
D. 35M-50M—Good.
Contract: 1,600 tons. Jan. 1, 1906.

Incorporated 1888, under laws B. J., auth. cap. 50M; 25M paid in. Statement Aug. '02: Assets 126M; surplus 72M. Well regarded, reported prompt pay and sold requirements without hesitation.
Estimated worth 40M net.
D.—2-25-04.
Mar. '04: Gave mtge. 30M covering property.
Jan. '05: In view of mtge. capital rating withdrawn.

"This card is kept up to date, any change in the affairs of a customer worthy of note being added. Thus I can hold the history

**of a customer in the palm of my hand while conversing with him. Where the credit man has to manage hundreds of accounts, he is very likely not to remember important details about a customer at the proper moment, and this card, I think, will obviate such a possibility. For instance, I can hear somebody in the outer office inquiring for me, the clerk will ask his name, which is 'Mr. John Doe.' I then recall that 'Mr. John Doe' was to call this week in reference to some accommodation. While he is being admitted, I secure the customer's card, read it quickly, and know without hemming and hawing just what to do. Also in approving a large number of orders, these cards bring pertinent facts to mind."**

Credit reference cards are not used to any great extent. Some credit men prefer to look over the credit information upon a man and also consult the ledger before discussing with him the question of his slowness, an extension of credit, or an extension of time on an account that may be owing. If the material that should be incorporated in the credit reference cards is tabulated promptly, *as it should be*, the credit man is saved many steps, and there is given him in a brief space, just as explained in the quotation, the data he should have before him.

Some years ago the National Association of Credit Men issued a credit reference card in connection with other forms for credit-office use. This card was an extremely simple form, $4\frac{1}{2} \times 2\frac{1}{2}$ inches, and could be so arranged as to contain entries referring to the amounts of the sales, method of payment, and agency ratings for a period of eight years; in addition to this, leaving a small space for notes that it might be necessary to make upon the card. It requires considerable labor to keep these cards up to date, but the benefits to be realized, especially in the credit office of a large house, certainly justifies the expense of making the tabulations with promptitude.

## THE TACTFUL CREDIT MAN

A credit man of experience realizes to what an extent he is dependent upon the good will of others for credit information and other assistance which can be rendered by his associates. It is necessary that he should be tactful in his bearing toward those associated with him, but just as essential that he should exhibit these qualities in his relations with customers. When a customer is in difficulties he will be more willing to make known the exact condition of his affairs, and at an earlier and therefore safer time, to a credit man he looks upon as a friend than to one he does not hold in that regard. If every case of financial embarrassment were taken in hand at the proper time, which means when the first acute state of embarrassment develops, an amazingly large percentage of the losses from bad debts could be saved and the retirement of many men from business obviated.

## CREDIT-OFFICE CORRESPONDENCE

While the credit man may meet many of the customers of his house, there are a large number of them he never has an opportunity to meet, for the reason that they rarely visit the market. When they do, it may not be convenient for them to call at the credit office, although the practice of having the credit man meet every customer who visits a business house is one that should be followed. If it be only to exchange the most formal greeting, it is well that he should have an opportunity to see the man to whom he gives credit, and have the customer see the person with whom he must necessarily conduct considerable correspondence during the year.

The commonest faults appearing in business correspondence are two: undue brevity and verbosity. A letter that is too brief gives the recipient the impression that the one writing it was pressed for time or did not consider the subject of sufficient importance to give it more than fleeting attention. Letters that deal with too much detail or are unnecessarily long rarely possess any force and are annoying to business people, for they have not the time to give to unnecessary words or phrases. That which is most desired, and naturally that which it is most difficult to attain, is the mean between these two extremes, and the credit man should endeavor to have his correspondence represent the mean and neither of these extremes.

## THE FALLIBILITY OF THE CREDIT MAN

One of the many debatable questions in the administration of credit is whether the credit man should be clothed with full authority to pass upon the credits of his concern, or whether there should be any reversal of his judgment. It is a common practice for salesmen to appeal from the decision of the credit man in regard to accounts and induce his superiors to decide upon a course contrary to that which he has outlined. There is much to be said on both sides of this question. The credit man has to acquire his experience in the same way that other business men have acquired theirs. The first years of his experience are largely years of tutelage, and there is no good reason why his judgments should pass unquestioned. A man may be appointed to the position of credit man and his ideas may be extremely large, especially as to the amount of credit he would accord to customers. It may be that the

concern is not in a position to spread its credit, and the members of the concern are justified in exercising a restraining influence upon the credit man if he displays a propensity to extend credits beyond the means of the house. Nothing can be lost by conference between the credit man and his firm on a point such as this, and, in fact, many others that come to the surface in credit work. The credit man may never have had an opportunity to meet the customer, either in his own office or at the customer's place of business; all that he knows has come to him through reports which may be somewhat faulty, as reports often are; and, after all, if a house be willing to trust a man, even though the opinion of the members of the firm be different from that of the credit man, it does not always follow that the house is wrong and the credit man right.

After a man occupies the position of credit man for a long period of years it is very seldom that there is any dissent from his views or that an appeal is taken from his decisions. The house has then realized, and the salesmen have come to learn from the excellent record the credit man has made, that it is advisable, unless some unusual circumstances should suggest otherwise, that the credit man be permitted to pass on the credits without let or hindrance.

## PAPERS AND PERIODICALS AS SOURCES OF CREDIT INFORMATION

There is another source of credit information which can be utilized to advantage, and that is regular consultation of the trade and daily papers for items affecting financial news, crop reports, industrial conditions, depressions, and labor difficulties, and also notices in respect to litiga-

tion affecting debtors. Mr. H. H. Sanger, in his article on "A System for a Bank's Credit Department" in *The Credit Man and His Work,* calls attention to this, and expresses the opinion that credit men should carefully read the financial pages of the morning papers. To the writer's knowledge there is a certain banking credit department where it is the special duty of a clerk to perform this class of work every morning, and everything that would possibly be of any interest to his credit department is underscored and clipped so that it may be filed with the regular credit information; in addition to which the clippings are carefully looked over by the credit man and later in the day referred to the officer of the bank who is in direct charge of credit matters. Possibly through this information lines of action are suggested and initiated long before other banks that are not as careful in the acquirement of this particular form of data have discovered any developments that might lead them to take similar action.

### THE CREDIT MAN AS A STUDENT OF LAW

In all discussions of credit work and the attributes of credit men there is some mention of the question as to how far a credit man should familiarize himself with law. In certain works on the subject of credit it has been the practice to insert a number of legal decisions bearing upon debtor's responsibility under signed statements, and kindred subjects. Nearly all credit men consult the legal periodicals, and every encouragement should be given to this practice. In addition to this, credit men are studying law, feeling that it will be of great help to them in the performance of their duties. None of this, however, means that the credit man should become his own lawyer.

Credit work is one distinct profession and the law is another. To attempt to merge them in practice would probably impair the efficiency of the duties discharged. Most credit men have not the leisure to devote themselves to the study of law. Those credit men who have, no doubt with great sacrifice, given their time to this study have not been able to acquire more than a general knowledge of its meanings. A smattering of law is helpful in increasing a man's general knowledge, but it does not mean that every man who has read some law is competent to act as counsel.

Hardly any two cases arising in litigation are exactly alike. While the same law may apply to them, in nearly every case there is some little detail that is different from that of the other. If, therefore, a credit man has a matter which he considers should be passed upon by a lawyer it is essential that he should consult a man who is thoroughly advised of the daily developments under court decisions. A decision rendered in the month of January in a certain State in regard to the liability of a debtor under a signed property statement, whether it be a civil or a criminal matter, may not be of the slightest value in ten months from that time. A credit man may understand the laws of a certain State in respect to property statements or chattel mortgages, deeds of trust, etc., but this knowledge may be of no value to him if he attempts to apply it to a person residing in a different State. Prior to the passage of the National Bankruptcy Act it was necessary that a credit man should have a good deal of general information respecting the State collection laws. This he gradually assimilated, because of his conference and correspondence with lawyers. It might be said that under the National Bankruptcy Act, if a credit man is well informed on

bankruptcy law, he does not require active counsel. This is also a dangerous position to take, for new law is being written in bankruptcy jurisprudence every day. The courts are rapidly developing a most extensive range of interpretation of this law, and action taken without the advice of competent counsel might lead to unfortunate results. The writer's views are those of a layman and one who has had considerable practical service in credit work, and they are designed to indicate the line of demarcation beyond which the credit man should not attempt to perform the functions of the lawyer.

# CHAPTER XVI

## COLLECTIONS

(*A*) *Collections: Their Nature—Systematic Methods—Unfavorable Developments: Their Effects Upon Further Credit—Treatment of Tardy Accounts—Collections Through Drafts: Draft Systems*

### COLLECTIONS: THEIR NATURE

THE collection of accounts is one of the most interesting duties of the credit man. Every good credit man is not a good collector and the best collectors are sometimes not the best credit men. Some men possess excellent capacity for analyzing credit information and selecting credit risks; but they fail to give to collections the same efficient service, and in this way nullify the good effects of their preparatory work. Accounts often regarded as worthy may, as time goes on, develop certain weaknesses. Conditions may develop during the term of the credit, especially if it be a long one, that could not have been foreseen by the credit man or anyone else.

Unless accounts are collected in full a loss results which, if pronounced, adversely affects the credit man's administration. The functions of the credit office are designed to prevent losses; consequently, when losses occur, it is supposed that the credit man has misjudged the character of the account, or has been unable to effect a satis-

factory collection. In either event the question of credit is affected.

The success of a business is determined to a large extent by the character of its collection service. Unless a house makes its collections with promptitude it will be embarrassed by lack of funds. No matter how ample its facilities for credit accommodation at its bank or through other friendly sources, there comes a day of liquidation, when it must depend upon the funds acquired from the collection of its accounts. Many houses have been forced into insolvency simply because their accounts were not collected promptly. This laxity affords opportunities to debtors for many kinds of imposition. The longer an account remains uncollected the greater the liability to certain developments which make it impossible for a debtor to render payment at all. A house that is in the habit of making its collections with the celerity that should characterize this branch of credit office work is usually a house that is "in funds" and has occasion to ask for the least accommodation; in addition, it commands the best terms in the market for its own purchases, as people are willing to extend to it better terms or discounts than they would accord to those from whom they could not expect either immediate or reasonably prompt payment. Some houses make purchases of large amounts of goods at low figures, because they are in a position to pay cash, or at least comply with the shortest possible credit term that the selling house may suggest. Having bought these goods on advantageous terms, they are in a position to offer them to the trade at prices that readily appeal to purchasers. Houses without the means of prompt payment cannot make such purchases and consequently are unable to compete

with their more fortunate neighbors. The importance of collections in this relation to credit work cannot, therefore, be overestimated.

The character of accounts has a material bearing upon the possibilities of prompt collection. When a credit man has selected customers of a very desirable character, little if any difficulty need be looked for in the collection of the accounts, providing collection is resorted to with promptitude. When, on the other hand, the credit man realizes that some of the accounts he has selected are not of the first class, he must of necessity anticipate difficulty in enforcing prompt collection. It has already been intimated that in a large business trade cannot be confined to first-class accounts without seriously curtailing the sales, which curtailment might be harmful. It may be accepted as a truism that in most cases a man can anticipate when he accepts an account just what will be the possibilities of prompt collection. The prudent credit man will keep the question of collections constantly before him from the time he is first considering an account, and never lose sight of the fact that a good credit also involves satisfactory collections.

Too much insistence cannot be placed upon the great merit of prompt action when an account becomes due. No debtor should have any objection to receiving on the due date a statement of his account. A man has the right to ask for that which is due him at the end of the term nominated in the bond, and his best interests demand that he should avail himself of that right. It is remarkable to what an extent men are inclined to pay their accounts quickly if payment is demanded with promptness. On the other hand, if a house is dilatory in requesting pay-

ment, debtors will be just as dilatory in rendering settlements. Another thing: the question of payment is determined largely by existing conditions. If a man receives a statement of an account due and he has had a satisfactory business for a few days, he is more apt to make payment promptly than if circumstances were not so propitious, so that the credit man who asks for payment when it is due is usually the man who receives it promptly.

### SYSTEMATIC METHODS

When a credit man is supposed to direct the collection of a large number of accounts, it is necessary that he employ some systematic method whereby he may be well informed in regard to their status. With a view to systematizing and minimizing the labor imposed upon the credit man incident to collection work, many systems of card indices have been invented and are in use. These cards are on the same general order as the credit reference cards described, and there is no reason why one card could not be made to answer the purposes of both credit and collection references. There are also cards known as maturity slips, used to indicate the maturity of accounts. These cards are kept in a tickler, so that the credit man (or collector in the credit office) may be reminded that such accounts are either due on certain dates or that payment on overdue accounts should be forthcoming upon such dates.

The institution of tickler systems has undoubtedly conduced to system in collections and has also influenced a better attention to collections. It is an easy matter for a credit man or his collector to turn to a tickler, pick out the cards that stand in a certain day, and see with a very

few glances from whom payments should be forthcoming. This is a great improvement over the old method, according to which credit men depended very largely upon their memories or memoranda made upon blotters or diaries, for these memoranda usually referred only to extreme cases and not to a large number of accounts, full information in regard to which can be obtained within a few minutes by consulting the tickler. The following rather novel plan has been recommended by a credit man of a well-known New York concern:

"All statements for accounts JUST matured are handed to a stenographer whose duty it is to make a record of the statement; giving date of bills, amount in total, name, address, and ledger folio.

"This is accomplished by the carbon system, to wit: Slips are cut similar in size to an envelope, as to width, and a trifle larger as to length; thus the operator is able to address her envelope and make the major portion of her record at one writing, and other details being filled in without removing the matter from the machine.

"These slips are then placed in a daily tickler, allowing reasonable mailing time for a response.

"Each day these slips are removed from the tickler by the assistant credit man, whose duty it is to look them up, and dispose of those paid, and hand me those remaining unsettled."

Although much more could be said in favor of such systematic methods as have been suggested, there is no evidence that they are universally popular among credit men. Some men say that after experimenting with card systems they have found it advisable to discard them entirely and depend upon the old-fashioned method of looking after collections. It is found, however, that it is usually among houses that do not have a large number of accounts that the card and tickler systems are not popular; although a credit man who claims to have eight thousand

accounts has told the writer that he prefers the old method of examining his ledger at least twice a month and depending upon it for such information as he requires from time to time in respect to accounts. It has also been the writer's experience that many other credit men have a strong preference for this method of examining ledgers. Some also believe that it is a wise thing to go over the ledgers with the salesmen and discuss each account in which they may be interested, as this gives the salesmen an excellent idea of the condition of their customers' accounts and imposes upon them an added sense of responsibility in promoting the practice of prompt payments among customers.

There is much that may be said as to the advantages and disadvantages of these different methods for "watching accounts." While the labor of keeping credit reference and collection cards is considerable, this work can be done by subordinates, and the necessary tabulations need not impose any labor upon the credit man. After this tabulation has been made and the cards are ready for his inspection at all times, he can consult them with greater ease than he could refer to the ledger. For instance, the tickler may be kept on his desk, and he is not distracted by having to leave his own office and go to the Accounting Department. When we appreciate that the credit man is a very busy person, the question of time and labor saving is an important one. The credit man who understands how to economize his time and labor can devote more attention to the thoughtful work pertaining to his duties and the mechanical portions need not give him much concern. In addition, if a credit man desires to look over the ledger in the daytime, he disturbs the bookkeeper and this makes for delay, probably occasioning night work, which should

be avoided. There are times for work and for rest, and the credit man who does not find it necessary to carry his labor into the time that should be devoted to rest is usually the man who is in the best physical and mental condition and the best able to discharge his duties.

### UNFAVORABLE DEVELOPMENTS—THEIR EFFECTS UPON FURTHER CREDIT

A credit man on being asked to what influence he attributed the large percentage of losses from bad debts replied:

"In my judgment, losses do not arise from opening the wrong kind of accounts nor from the want of skill in closing them, but principally in the handling of accounts while they are alive."

This opinion certainly explains the causes of many losses. During the pendency of an account the credit man should be on the alert to detect any unfavorable conditions that may arise; and if there be no good reasons for immediate interference with the debtor, he should at least insist upon prompt payment at maturity. Too frequently, in the face of unfavorable circumstances, the credit man hesitates to take action because the account has still some time to run, and awaits the due date in the hope that payment may be made and the necessity for attempting to enforce it obviated. It is upon this rock that many credits are shipwrecked.

Tardiness in settlements is always a danger signal. A credit man may learn before an account falls due that the debtor has become slow in his payments with others. Due recognition should be given to this fact the same as though it were the credit man's own account which was lagging.

Tardiness in making payments is the most common symptom of financial weakness, and business collapses are invariably preceded by slowness in making payments. Dilatory payments arise from many causes—business depressions, extravagance, too large expenses, overstocking, poor business methods, unwise investments in outside enterprises, or sickness and death in the immediate family of the merchant. These are among the principal causes. When payments are tardy the credit man should immediately investigate the causes. He may find that they have arisen from conditions that were entirely beyond the control of the merchant; or that the merchant is directly responsible for them. The credit man must determine what has occasioned delays in payments, otherwise he will be at a distinct disadvantage, as it is obvious he cannot extend intelligent management to an account unless he is reliably informed in regard to the actual condition of the merchant's affairs. It is at this period in the life of an account that the credit man is confronted with one of the most delicate and trying problems in credit economy. He must decide whether to insist upon a settlement necessitating, in all probability, the adoption of radical measures, thus attracting the attention of other creditors who will in turn take similar action with the possibility of forcing the debtor into insolvency, or trust to circumstances.

It is well known that many merchants have been forced into insolvency or liquidation, with great loss to themselves and their creditors, because certain credit men have adopted strong measures, when a policy of lenity coupled with prudent administration by the creditors would have maintained the estate whole. If the causes which have occasioned the merchant's slowness are found to be entirely

legitimate, and his liabilities bear such relations to his assets as would suggest good prospects for recovery, an extension of time may be conceded with a fair degree of safety. It is well understood that too large a measure of indulgence on the part of creditors is very often the basis of imposition by debtors, who divert the graciousness of their creditors into a means whereby they may make preparations for failures at such times as will best serve their own purposes. When a merchant finds it necessary to ask the consideration of his creditors on accounts already owing, the corollary is that they must continue to furnish him with goods in order to meet the demands of his trade and maintain his stock in fresh and salable condition. The word "must" as used may indicate something of a more mandatory character than is really intended, as creditors cannot be compelled to furnish a merchant with goods unless they feel disposed to do so; but they are under mandatory influences, for their failure to supply the merchant with goods will embarrass his possibilities of continuing in business under favorable conditions; the fact that he is owing so generally almost inhibiting him from seeking credit in new quarters. So that, while the creditors are depending upon the possibility of the merchant's success in order to secure payment of their accounts, he must depend upon them for the means whereby he will be able to continue in business.

It is at this particular time that the elements of character and capacity play a momentous part in credit, for the capital may be impaired or be in danger of imminent impairment. The merchant's good character will lead him to deal honestly with his creditors and safeguard their interests so far as he may be able to do so. The element of

capacity will serve him in developing the business and bringing success out of what might have proved a failure.

Sentiment has much to do with directing the judgment of the credit man in the same degree that it influences the doings of men in every department of life. Although many brave attempts are made to prove that in these days sentiment is an immaterial quantity in business affairs, the fact remains that probably nowhere does sentiment prevail to a greater extent than in credit work. When a merchant has patronized a house for many years, bought from it a large portion of his goods, paid promptly, and ostensibly held the house in high esteem, it is difficult to eliminate the influence of sentiment when the house finds it is called upon to bear with that merchant because his business has taken a backward turn. Some men are so constituted that they can disregard the favors of a lifetime and the obligations that are supposed to follow such favors, but these men represent a very small number. Except where a house controls a specialized article, business is to a great extent a matter of favor which a merchant extends according to his personal preferences, either for the salesman or the proprietor of a concern. When such a merchant becomes slow in his payments the credit man is supposed to display that Spartan impartiality that knows no friendly ties. While he may consider that from a material point of view it would be better for him to assume this attitude, it is still true that there are only a few credit men who can bring themselves to occupy it. It is a question of either bearing with the merchant or cutting him entirely aloof and adopting such means for the collection of his account as the most cold-blooded and sordid considerations would suggest. Mr. Fred. A. Smith,

the credit man of the well-known house of Reid, Murdoch & Co., of Chicago, recently wrote a paper on this very topic, entitled "When to Let Go of an Old Customer." He says on this point:

"The question then naturally arises, How should such cases be treated? I believe the simplest way is to avoid them by watching all delinquent accounts more closely, renewing information more frequently on old customers that are inclined to be slow, secure coöperative experience of others selling the same party, either direct or through a clearing-house system, and if found that other creditors are having a similar experience, it is high time to demand an exact showing of actual conditions, either by a 'heart to heart' personal interview or securing a property statement by correspondence, and draw your conclusions as if a new account was being opened, barring all sentiment.

"If the customer cannot be shown in a kindly manner that his boat is nearing the rocks, both time and money will be wasted by all concerned in encouraging further extensions or increasing the indebtedness. Such an account should be gradually closed, retaining the friendship of the customer if possible. At such times, however, every conscientious credit man should rise above the sordid question of dollars and cents, and realize that to a certain extent the debtor's entire future is at stake and may rest entirely in his hands, or depend on the advice given or action taken at such crucial periods. No mistake should be made, as the future interests and welfare of not only the debtor, but his family as well, are involved, and a false move may result in a life failure or perhaps a tragedy that might have been avoided by the right word or good advice from a creditor. This confirms my former statement that closely watching the business pulse of the customer, as shown by his ledger account, may prevent the disease advancing to a serious stage, and by showing the man the cause of his troubles bring about a change of methods—the same as a good physician will use every means to effect a cure before resorting to heroic methods of surgery. Occasionally a man shown his weakness by a stranger with whom he tries to open an account will realize that his old friends were correct in giving the same advice, to which he had taken exception."

Mr. Smith's views are in line with the best thought among credit men on this subject, when he advises that such accounts be carefully watched and information respecting them revised so that the credit man may take advantage of any facts brought to light in these investigations. Personal contact and interviews with the customer so circumstanced will be a great aid to the credit man in determining upon the best course to pursue. In addition to all this, as Mr. Smith well says, the customer's entire future and the welfare of himself and his family may possibly depend upon the judgment displayed by credit men in their treatment of him when he has become dilatory in his settlements. No credit man would want to feel that through undue pressure on his part he had been responsible for the downfall of a merchant, especially if by kindliness and a greater interest in the outcome of the merchant's affairs he might have assisted him to escape from his embarrassment.

## TREATMENT OF TARDY ACCOUNTS

When accounts are not paid at maturity, the credit man must resort to certain means for inducing payment. It is principally to guard against the possibility of overlooking such accounts that systematic methods have been instituted. There is danger, however, that a too rigid application of certain collection systems may in the end defeat their own good purposes. The time required to exhaust the utilities of these systems may have brought the debtor from the point where payment might have been secured through more effectual means, to where it is almost impossible for him to make payment under any circumstances. For instance, a credit man has explained

his system thus: If an account is not paid within ten days from maturity, he makes a draft for the amount payable. If this draft is not paid within ten days, he writes a letter; if no response is received to this letter within ten days, a second letter is written; if within ten days from the mailing of the second letter no attention is paid to the account, he makes a threat to send it for collection, and if within ten days from the making of that threat the claim is not paid, it is then sent to an attorney. The writer has no intention of impugning the utility of this particular system as applied in certain trades. It may be entirely efficacious in some but it would not be in others, as the lapse of time occurring where all the features of this plan were followed might negative the possibility of making a collection.

Unless given judicious assistance, debtors are more inclined to go from bad to worse than from bad to better, and while it is freely conceded that credit men, especially in these days, must employ systematized methods (the large number of accounts they handle necessitating this if other good reasons did not), we are brought back to the idea underlying all credits and all collections, viz., that every account should be judged on its merits, whether at the time it is opened, during the time it is running, or when due. Machine methods, while they may suffice for small accounts, are not adequate as a governing force for accounts generally. All trades seem to differ in their habit of treating collections; the habits and standing of men differing so radically, uniform treatment of them is out of the question.

In certain trades it is the custom to immediately make a draft on a person if he does not pay his account, and

advices to this effect are printed on the statements of the account when rendered. Some merchants care so little whether or not drafts are made upon them that they purposely delay paying their accounts, knowing that a draft will be made, and they thus get the advantage of the additional time. Creditors attempt to overcome this practice by charging interest on the account for the excess time; but they are not always successful in collecting it. As a general rule, the debtor gets the advantage, and this petty imposition (as well as many other similar impositions on creditors) will obtain until business men insist upon certain regulations being respected by those to whom they sell. The thirst for business, however, leads houses to countenance these unfair practices, and the creditors are largely to blame for their prevalence.

In some trades, when an account is not paid at maturity, the credit man writes to the customer, requesting an explanation for the omission and asking that a settlement accompany the reply. The credit man in his letter-writing may either do much to induce quick payment, or offend and antagonize the debtor. A credit man of long experience has remarked

> ". . . that dignity and businesslike methods in correspondence are appreciated as fully by a delinquent debtor as by anyone else."

If a debtor will not make a satisfactory reply to a letter, especially one that merits proper attention, there is little reason to suppose that he will pay a draft except on the presumption that some merchants do not like to have drafts made upon them. The draft system has been developed to such an extent that in many trades the old

disinclination of debtors to have drafts made on them has largely disappeared. The sting has been taken out of the process, so that why the making of a draft should be the next step *per se* is not entirely clear. The credit man possibly thinks that the making of a draft may afford him further and more satisfactory evidence of the debtor's unwillingness to pay, and thereby suggest such further action as may be necessary; again, there is always *the hope* that the making of a draft may produce payment. The system employed by one of the most representative dry goods concerns of the Middle West is to mail a statement of an account when it is due, and if within ten days from the time that the statement is mailed no response is received, to send a lithographed letter, which reads as follows:

"Is there any misunderstanding relative to the amount now due upon your account, according to the statement mailed to you about ten days ago?

"Kindly let us hear from you at your earliest convenience.

Very truly yours."

If no reply be made to this letter and the amount be a small one (less than $500), a draft is then made for it. If neither payment nor a satisfactory explanation be forthcoming, one of the regular adjusters from the credit office calls upon the customer, although when the accounts are small they are sent to an attorney. The credit man of this concern has said to the writer:

"We find by having our own representative investigate the case upon the ground, discoveries are often made which are most valuable, and if the customer is responsible but careless, the account is not lost by a procedure of this kind, considering that we only employ diplomatic adjusters who do not publish their business in the town where the merchant resides."

This method seems to more nearly approximate a broad and judicious treatment of accounts than a recourse to stereotyped letters, drafts, or collection letters, especially as the system brings about an early and practical investigation of the customer's affairs. This is not possible under systems that consist solely in letters, drafts, or collection forms, as the loss of time incident to the use of these methods is considerable and therefore an element of danger.

## COLLECTIONS THROUGH DRAFTS—DRAFT SYSTEMS

The practice of making drafts upon customers for overdue accounts is quite an old one. Except where it is a regular feature of collections and tacitly agreed to by debtors, the sending of a draft is accepted as an indication of the creditor's desire to insist upon payment forthwith, and sometimes as an unfriendly action. The limit of indulgence permitted before a draft is made depends to a great extent upon the views of the credit man as to how much extra time should be allowed. Some credit departments are perfectly willing to wait for ten days after mailing a statement before making a draft, while others send a draft if an account is not paid by return mail; others allow from three to five days, but there is no established rule. For the collection of small accounts the draft system undoubtedly has its advantages, and because of these advantages the collection agencies some years ago devised methods by which drafts could be utilized to collect claims from delinquent debtors. The collection agencies prepared these drafts, to which were attached stubs directing that in the event of non-payment the banks delivering the drafts hand them to the attorneys named in the stubs.

The debtor could thus see that his refusal to honor the draft would bring him face to face with the unpleasant alternative of inviting an attorney's attention to his affairs, a contingency which men prefer to avoid.

The draft system in its original form—i. e., as unrelated to the work of collection agencies—has had a very thorough test, and many believe that its results are excellent. The making of drafts has also developed a point of difference between banks and credit men. The latter hold that banks should be willing to give the most careful attention to the handling of drafts, irrespective of the possibilities of making collections; also that the banks should be satisfied with the slight collection charges they deduct when drafts are collected. The recompense for handling the larger number of drafts that are not paid has not been made clear, except by some credit men, who, taking a broader view of this subject, inclose a remittance of ten or fifteen cents with each draft, so that no matter whether it be paid or not, the bank has received some compensation for its trouble. Credit men who follow this practice state that they have no difficulty in making such collections through banks, and that the drafts they send forward in this way are given courteous and efficient attention.

The collection-agency draft system also has many advocates among credit men who consider that it is an efficacious method of handling dubious accounts. There are others quite as positive in their condemnation of the plan, asserting that systems which provide for handing an account to an attorney in the event that the draft is not paid do more harm to the merchant than if the account had been sent to an attorney in the first place. There is

merit in this adverse criticism. When a credit man uses one of these collection-agency drafts, he is calling the attention of the bank to the fact that he regards the account as being in such condition that if the draft be not paid it should be given to an attorney. Giving an account to an attorney is the last step, and the consequence may be an injury to the reputation of the debtor. It may be contended that when a man will not pay he is not entitled to any consideration, and that there is no reason why he should be protected from such knowledge becoming public. The creditor's ability to collect an account may depend upon the knowledge of the debtor's unsatisfactory condition not being a matter of publicity. The moment it becomes such, the attention of all creditors is invited, with consequences to which we have already called attention, viz., forcing the debtor into insolvency; so that for his own sake the creditor should abstain from doing anything that would adversely affect the possibility of payment being secured. The draft systems employed by collection agencies prove attractive to credit men because there is little expense attached to them. Some agencies charge a regular subscription price, and as a part consideration furnish the creditor with books or pads of drafts which he can use whenever he desires. In other cases the drafts are sent through the collection agency, and the charge is a very moderate one.

# CHAPTER XVII

## COLLECTIONS—*Concluded*

### (*B*) *Collection Letters—Attorneys-at-Law as Collectors—Adjustment Bureaus or Administration by Creditors—Suspended Accounts*

### COLLECTION LETTERS

FAILURE to pay an account when a draft is made is usually an indication that a debtor's delinquency is of a pronounced character, and it is then deemed advisable to adopt some course that will prove more effective. Some houses prefer to make several drafts, for the reason that the expense entailed is trifling, but an unpaid account always reaches a stage in which the draft is ineffective and some different method must be employed. With many concerns this method consists of sending what is called a "collection letter." This is a printed form containing spaces for entries of the name and address of the debtor, the amount of the claim and such other data as it is not possible to include in the perfunctory printed matter. The collection letter is an outgrowth of systems devised by collection agencies, and is a distinct method of enforcing collections, especially in cases where the debtor is a confirmed delinquent. These collection letters usually consist of a series of communications, the first being

a temperate notification that payment is expected; if no adjustment of the claim results from the sending of this letter, one couched in firmer language is then forwarded. If the debtor still prove recalcitrant, an even stronger communication is sent, stating that it is the final attempt to collect the claim in an amicable way and that recourse to legal proceedings will be the next step.

A short time ago some enterprising collection concerns conceived the idea of preparing series of collection letters on the order described, accompanied by envelopes bearing the name of the agency, and selling them in lots to those engaged in giving credit, who would dispatch them to delinquent debtors; the impression made upon the mind of the debtor was that the communication had come to him direct from the collection agency. This practice is now a general one, and there are a number of concerns whose principal business it is to prepare and dispose of these so-called "collection letters." Prior, however, to the institution of this practice, many trade organizations conducted adjustment and collection bureaus, and employed collection letters with excellent results. The great advantage of this method was the little labor and expense involved. Collection letters are used at the present time by many trade organizations in collecting accounts for their members, and also by certain of the credit men's associations which conduct collection bureaus. One system followed requires the members of these organizations who use the collection letters to promptly notify the collection bureau; the bureau takes cognizance of the progress made in collecting the account, and if collection is not effected, steps in and takes active charge of the case. The plan followed in other organizations is that the mem-

bers shall notify the bureau (on a form provided) that an account is delinquent. On receipt of this notification the bureau sends the debtor a formal collection letter with the request that a remittance be forwarded direct to the creditor. If payment is received the creditor immediately advises the bureau. If a settlement is not made within a reasonable time, the bureau is notified to that effect and the officer in charge forwards a second or third letter, as the requirement may be.

The sale of collection letters has been carried on to a large extent, and the forms are in use by many credit offices. Under this system the collection concern, which is very often represented by a name only, is entirely divorced from any responsibility in the matter after it has sold the forms to the creditor. The debtor who receives one of these letters or an entire series of them from a creditor, believes that the collection agency whose name appears has charge of the account. He infers that the creditor has adopted outside means for enforcing the collection, and this usually marks an entire severance of business relations after the account is collected. It is inconceivable that a house would continue to do business with a man who had become so delinquent as to call for the use of a collection letter unless his business affairs underwent so material an improvement as to dissipate the possibility of a recurrence of the former unfavorable conditions.

The propriety of this plan, however, is open to serious question, and the fact that it is so regarded is proved by the statements of prominent credit men that they would not think of sending such letters to anyone but undesirable people. Others hold that the use of collection blanks

is only justified when a credit man has determined to close an account, as he would not care to adopt such means with a person whose patronage he desired to retain. There is a sharp division of sentiment among credit men as to the efficacy of collection letters under any circumstances, some believing that they are very effective, while others maintain that the exact contrary is the case.

The practice of using these collection letters has grown to such an extent that very reputable business and trade organizations have adopted forms and sell them to their members. The names of these organizations appear on the letters, and are used to force debtors to make payments of accounts, in the fear that their failure to make payment will bring down upon them the unfavorable action of these organizations, whose memberships will be informed of their delinquency. In cases where collection letters convey this threat and the organizations using them carry it into execution, the system is entirely warrantable and everything may be said in its favor, providing that its utilities are not exercised to wring from a debtor payment of an amount that he should not be called upon to pay. Many trade organizations and some of the affiliated branches of the National Association of Credit Men publish monthly or semimonthly bulletins containing the names of the delinquent debtors reported to them.

## ATTORNEYS AS COLLECTORS

When creditors find it impossible to collect claims through statements, regular correspondence, adjusters, drafts, and collection letters, the next and practically only recourse is to the services of an attorney. While it is

customary for some credit departments to act with more celerity than others in handing accounts to an attorney, he is generally regarded as the very last resource in an effort to collect; in fact, credit men admit that they exhaust every other known means before enlisting the services of an attorney. When an attorney receives a claim he must employ either one of two methods of procedure: first, to collect in installments, or second, to bring suit for the claim. He may in some cases secure a collection immediately or upon his first demand, but in most instances he has to collect the claim in installments, and is perfectly willing to bring about a settlement in that way. The creditor is agreeable to such a settlement, providing it involves the payment of the entire amount owing, preferring to suffer the disadvantages of the delay with the reasonable assurance of getting full payment, rather than incur the possibility of bringing about the financial collapse of the debtor through suit. No matter which method he follows, there is always publicity, for the fact that the attorney or his representative is calling frequently upon the debtor to make collections, or the debtor calling upon the attorney to make his payments, becomes a matter of gossip in the neighborhood, greatly to the injury of the debtor's credit.

Among the objections to placing claims with attorneys is the expense involved. The attorney is entitled to a fee for his services, and this invariably has to be paid by the creditor in the form of a commission upon the amount collected. This, as well as paying costs and fees incident to a suit, means a loss to the creditor. Franklin says in "The Way to Wealth," "It is foolish to pay out money in a purchase of repentance," and many creditors believe

that money spent to further the collection of bad debts is foolishly spent.

In the attempt to collect claims through attorneys a great deal depends upon the character of the attorneys; that is to say, the results that are expected will be dependent upon the character and capacity of the attorney. His capacity as a lawyer will enable him to exercise good judgment in handling the claim, which is practically handling the debtor; and his good character will be a safeguard to the interest of the creditor in assuring a prompt and satisfactory accounting for any money that comes into his possession. It is therefore important that credit departments should be reliably informed as to the standing of these attorneys. It is not an easy matter to determine what an attorney's standing may be, although the creditor class has been helped in this respect through the publication of attorneys' lists, the names in which are vouched for by the concerns selling the lists. As a further evidence of their confidence in the attorneys, many of the concerns publishing law lists offer with the subscription a guarantee for any moneys collected by the attorneys. These lists are known as "bonded lists" or "bonded attorneys." In some cases a house using such a list is at perfect liberty to forward claims directly to the attorneys whose names are given, notifying the publishing company, however, as to the sending of each claim. The notification to the publishing company is a necessary precaution, otherwise it would never be in a position to know to what extent its guarantee was being called upon. In other cases, however, concerns publishing lists do not extend a guarantee on the attorneys unless the claim be forwarded through the office of the publishing company.

While conceding the representative character of certain law lists, some credit departments prefer to have their own lists of attorneys, and this is notably the case with large concerns. For instance, Mr. Fred. E. French, of the Credit Department of Messrs. J. V. Farwell Co., of Chicago, was asked by the writer what means he employed for sending claims for collection and replied:

"For a number of years past, we have had a regular list of attorneys, altogether numbering possibly 1,000, and in compiling this list we make a particular effort to not only obtain ability, but honesty, in consequence of which we have not lost anything in over five years through dishonest representatives. We investigate the standing of our attorneys the same as we do that of a customer, and after being satisfied that they will fulfill our requirements, we mail to them a list of the accounts which we are selling in their immediate neighborhood."

Such a list as that described by Mr. French is a very valuable asset of a credit department. It is especially so where a house employs a corps of adjusters, as these adjusters know to what lawyers they must go for advice, and are therefore never at a loss to avail themselves of legal services whenever necessary.

A great mass of the collections forwarded from different points are sent through collection agencies, and opinion among credit men is divided as to whether it is best to forward claims through collection agencies or direct to an attorney. Much depends upon the character and size of the claim. Small claims are sent either directly to attorneys or through collection agencies without hesitation. When the claim is a large one, and the questions involved of a delicate character, the services of a competent adjuster or the personal counsel of the house

will in all probability prove more acceptable; some credit men of long experience assert that in the collection of large claims, they prefer to send their own personal counsel rather than to forward the claim to a local attorney. This course is preferable when a house has no regular correspondent at the point where the claim arises, and must depend upon a law list or other avenue of information for a recommendation of the attorney to whom the claim should be sent. When a house sends its own counsel, it knows exactly to whose hands the business is intrusted, and therefore must feel safer as to the outcome, although it does not follow that the ability of the personal counsel is any better than that of the local man who might be selected. One of the supposed advantages of sending claims to collection agencies is that it means a great saving of labor to the credit man. The collection agency is expected to follow the claim step by step, to be thoroughly informed of all developments in regard to it, and to see that the attorney to whom the claim is sent does his full duty. It does not follow that the credit man is relieved from all attention to the matter, further than inquiring from time to time as to the state of the case.

A credit man who assumes to give the collection of bad debts the attention it deserves will be anxious to know as much about the progress of the claim as the collection agency itself; he must be constantly informed in regard to it, and also compile the data respecting the claim and keep it in shape for reference. This involves considerable correspondence, and if he must go through all this correspondence with the collection agency, why could he not carry on the correspondence just as effectually with the lawyer to whom he might send the claim directly? It may

be said in answer to this that the credit man, although a very competent person, may not understand the special advice that should be given from time to time in order to assist in the collection of the claim; or may not be informed as to the many methods that expert collectors would employ, it being assumed that those in charge of the collection agency have all the expert knowledge and acquirements in a very marked degree. This may be true of some collection agencies; it certainly is not true of all of them.

Now, it is admitted that a collection agency is in a position to give an attorney a large amount of business, while an individual house may give him only a small number of claims every year. At the same time, if many houses were to retain this same attorney, the aggregate of their business would be considerable. In addition to this, when a claim is sent to an attorney directly, he commands the entire fee and is not called upon to divide with a collection agency. However, it is this very question of fees that affects most largely, for where a great deal of business is sent to an attorney through a collection agency, he makes more in the gross, although his single fee is smaller than upon claims sent to him directly. It must also be admitted that a collection agency, in doing a large amount of business in a certain territory, as suggested, is in a better position to judge of an attorney's qualifications than a creditor who sent claims directly. The creditor very rarely has the time or inclination to make an extended investigation of the attorney's standing unless this question be given the studious attention advanced in the opinion of Mr. French. The view as to the agency being in a position to furnish the creditor with pro-

tection against defalcations of attorneys is a sound one, although it has been explained that there are many reliable law lists which are guaranteed in this respect, and consequently firms that send their claims directly to these lawyers are guaranteed just as fully as though they forwarded the claim through a collection agency carrying a bonded list. No doubt this question is very often determined by the personal predilections of the credit man. Some credit men prefer to handle claims through their own attorneys, as they feel that they are informed more promptly as to progress than if they had to wait for reports from a collection agency.

### ADJUSTMENT BUREAUS OR ADMINISTRATION BY CREDITORS

Under the State system for the administration of insolvent estates every incentive was offered to creditors to act independently in attempting to establish the precedence of their claims. The National Bankruptcy Act having superseded the State system, and the spirit of that law making for equality, creditors are becoming educated to the principle that coöperation of interests is a useful force in administering the estates of insolvents. The result has been the establishment of adjustment bureaus by business organizations, a movement which has developed considerable strength among the credit men's associations. This is a splendid augury for the existence of better relations among business men, redounding to the benefit of both creditors and debtors.

When a debtor finds that he cannot continue payment and that the liquidation of his business would show a loss, he should assure his creditors of his willingness to

place the business in their hands and abide by their decision. The debtor who approaches his creditors in this spirit invariably finds that they will receive him in an open and generous manner. A conference will then take place, and a plan devised for conducting the business or adopting any other measures which the peculiar conditions involved may suggest as being the wisest.

The bankruptcy act aims to reach this result; but it is also true that creditors can accomplish the same end with less expense than would be attended by the administration of an estate under the bankruptcy act, and vastly less than under the State laws. If a debtor considers that he is likely to receive liberal treatment from his creditors, he will be more willing to put his affairs in their hands. The greater the prevalence of this policy and this spirit, the greater will be the willingness of debtors to confide in their creditors and the less loss there will be from failed estates.

The inevitable result of this line of action is a satisfactory settlement for the creditors and a return of something at least to the debtor. The adjustment of crippled estates under the direction of creditors is not a new departure, although it is now receiving more attention than ever before in the history of this country. There have been merchants' protective associations in existence for many years, some of them as old as twenty-five and thirty years, and older, and they have served a good and noble purpose.

One of the special functions of the National Bankruptcy Act is the adjustment of estates through compositions; but compositions can be effected just as admirably through organizations of business men. In some cases of insolvent estates the business is conducted under the direc-

tion of creditors or trustees appointed by them, until a certain amount has been realized, and the business is then transferred to the debtor. Or, if the condition of the business warrants, a composition may be entered into involving a deferrence of the payment of the amount stipulated over a specified time, during which the business will remain, at least nominally, in charge of the creditors or some one acting for them.

Any system for the administration of insolvent estates which involves concert rather than division of action among creditors is of manifest superiority. The commercial, trade and credit associations of the country can revolutionize the influences and practices which have heretofore obtained in the winding up of insolvent estates. They can make the process one of great benefit to themselves, while it will also have the effect of maintaining in business many unfortunate men who under the old systems would have been forced to retire permanently. The establishment of adjustment bureaus under the auspices of the credit men's associations is a healthful and pleasing development.

## SUSPENDED ACCOUNTS

When a debtor has failed or his account has been given to an attorney for collection, or there is any reason to question its worth, its character has assumed such an aspect as to require that it be placed in a class with others of a similar nature. These accounts are known as "suspended accounts," deriving this name from the fact that it is customary to suspend action, either as to charging them to profit and loss or such other course as may be necessary until developments warrant some definite policy being pursued. When an account is sent to a lawyer for collec-

tion, or other extreme measures adopted, it is evident that its value as an asset has been impaired. There is no good reason, therefore, why such an account should be retained upon the general ledger of a concern and reckoned at its face value, so that it is customary in well-conducted business establishments to either charge such an account immediately to profit and loss or place it in a suspense account. The reasons for this are obvious. No upright firm desires to deceive itself or its creditors as to the value of the accounts due to it. The only safe way to avoid such accounts being included among the good accounts and face-value assets is to see that they are segregated, where their character will not be misunderstood and their approximate value, only, computed.

Suspended accounts belong to a separate branch of credit-office work, and special treatment should be accorded to them. In order that this treatment shall be efficient, it is necessary to adopt the same systematic methods for their government as in the case of live accounts. Card systems may be utilized to excellent advantage in treating suspended accounts. It is the practice of many credit men to use card systems for tabulating data respecting these accounts and directing their management in an orderly way. The correspondence incidental to suspended accounts in time becomes voluminous, and a folder system on the same general order as that employed for docketing credit information may be used. In this way there would be no appreciable danger of the credit man overlooking such work as is necessary in regard to suspended accounts. It is true that many firms hold it almost a waste of time to pay much attention to this class of accounts, for, as a general rule, there is little realized from them. It is partly

because of the inadequate attention given that so little has been realized from them. Credit offices that give conscientious thought and effort to the manipulation of suspended accounts know that they have realized very much more than would have been possible if the debtors had been allowed to go their way unthought of and unmolested.

Another reason why every bad or doubtful account should be investigated is that the information acquired will assist the credit office in deciding upon the wisdom of reopening the account if in after years the same person should apply for credit. A man may make what can with perfect propriety be called an honorable failure. If he rehabilitates himself and asks for credit, the records show that he emerged from the failure with an unstained character; also that the reasons for his failure may not have been such as to cast serious doubt upon his capacity to conduct a business successfully if the circumstances were different from those under which he had formerly operated. These facts are of the greatest value to the credit man, and of benefit to the merchant. But if a man's former failure or business record indicated a lack of moral stamina, this is an important thing for the credit man to know. He would be without this knowledge if failures and bad debts were not thoroughly investigated, and the results of the investigations preserved in the files of the credit office.

# PART FIVE

# GENERAL QUESTIONS

# CHAPTER XVIII

## LEGAL REDRESS—THE BANKRUPTCY ACT

The theory upon which legal redress for unpaid or failed accounts is sought, is based upon the presumption that there has been a violation of contract. There is probably no element affecting the development and welfare of the human race that has exercised a more potent influence than the element of contract; it is clothed with a traditionary power, the import of which cannot be overestimated. Prof. Henry Sumner Maine attests the antiquity and universality of contract when he says in his work on "Ancient Law":

> "Neither ancient law nor any other source of evidence discloses to us society entirely destitute of the conception of contract."

A sale is one of the commonest forms of contract known to the human family. When a merchant is unable to collect the amount of a sale, he appeals to the law. Society, having from time immemorial recognized the certainty of mercantile disputes and misadventures, adopted laws under which the rights and interests of creditors and debtors would be safeguarded and protected from the predaceous encroachments of members of either element upon the other. But an orderly dispensation of justice required that all laws be administered by those competent and

trusted, and consequently courts were instituted for the solution of questions requiring the sanction of judicial interpretation.

The merchant proceeds on the principle that he is entitled to some compensation for the damages sustained through the debtor's violation of the contract, and this satisfaction it is his right to attempt to secure. The character of redress may be determined in many different ways, according to the legal customs of the nation or state to whose laws he makes appeal. During the greater part of our life as a nation, legal complications between creditors and debtors were settled by recourse to State laws, unless an adequate compromise was offered. The creditor often preferred to secure a judgment against the debtor and hold it until such time as the debtor might come into possession of sufficient property to enable the creditor to proceed against such property by virtue of his judgment; although this course was impossible, so far as resident creditors were concerned, where an estate was administered under an insolvency law.

The best-known forms of law under which the relations of creditors and debtors have been adjusted in English and American jurisprudence are bankrupt laws, insolvency laws, and the common-law assignment. The disposition of all nations, however, has been toward the adoption of bankruptcy laws, under which legal redress is now generally sought where the interests of the creditor have been damaged through the debtor's failure to make payment. The developments of bankruptcy legislation have wrought in that system some astonishing changes. Where the first bankrupt laws presupposed guilty action or fraudulent intention on the part of insolvent debtors, the principles upon

which these laws are now based do not primarily concern themselves with fraudulent practices. The present laws relate to an equitable distribution of the assets of an estate among all the creditors, and the debtor's discharge from his liabilities, provided he has not been guilty of misconduct, so that he may again embark in business life untrammeled by a burden of debts.

Bankruptcy laws are of mediæval origin. They were first introduced in some of the Italian States, and later adopted in France and England. It is now generally conceded that bankruptcy laws are an outgrowth of the commercial system, their development from the very earliest stages being prompted by the requirements of commerce. In this country they have been recognized as a necessity of the commercial system. (See "Bankruptcy a Commercial Regulation," by James M. Olmstead, of Boston, *Harvard Law Review*, vol. xxv, No. 10.) The first English bankruptcy law was passed in 1542 during the reign of Henry VIII (34–35 Henry VIII, C 4). Since that time England has had some thirty-eight bankruptcy statutes (including amendatory laws), the last having been passed in 1883, but undergoing material amendment in 1890. In England, as in this country, bankruptcy law has had its friends and always some very powerful opponents. The principles of English bankruptcy law have been used as the basis of similar statutes adopted by other nations, one of their strongest features being the composition provision, which has been also written into our present law. Bankruptcy laws are in force in all the great nations of Europe, and their adoption has been coincident with the marked commercial expansion of those nations.

Bankruptcy legislation in the United States is based

upon the authority conferred upon Congress in the Constitution, which says that "Congress shall have power to establish . . . uniform laws on the subject of bankruptcies throughout the United States." This power is one that the Congress may exercise or disregard at its discretion. Its relation to the credit system is set forth in no uncertain way in a report of the Judiciary Committee of the House of Representatives, dated July 21, 1841, as follows:

> "Credits, or demands, are property in which, not infrequently, the bulk of large individual estates consist. As property, they are under the protection of the law as much as any other kind of property. All the rights of property attach to them; the right of protection and defense against all encroachment and injury, and the right of recovery when wrongfully taken away or withheld. They are private property, and private property is sacred. It must be respected; and the law must be vigilant and efficient in its guardianship of it. Failure in this is failure in the highest duty of civil society, and tends directly to dissolution."

On three occasions (1800, 1841, 1867) prior to the passage of the present act Congress enacted bankruptcy legislation. The very short life of the first two laws and the limited existence of the third offered little basis for the development of a thorough appreciation of the precepts of bankruptcy legislation such as the needs of this commercial people really required, and also gave rise to much misconception as to the duty of Congress in respect to this legislation.

The absence of bankruptcy laws committed the administration of debts to the bankruptcy and insolvency systems adopted by the different States; for while such State statutes are suspended by the existence of a National Bank-

ruptcy Act, in the absence of a national law the State laws are in full force, or,

"The States may legislate on the subject of bankruptcy if there be no law of Congress which will conflict."—(Cooley, "Constitutional Limitations.")

The phraseology of the Constitution on this subject has given rise to much dispute as to the real intent of the framers of the Constitution in conferring upon Congress the power to adopt uniform laws on the subject of bankruptcies.

"Just what the Federal Government meant by laws on the subject of bankruptcies, has been disputed. The commonly received view is that an insolvent person, or one unable to pay his debts, is a bankrupt, and that a law dividing his property proportionally among his creditors and discharging him from legal obligation to make further payment, is a bankrupt law." (Hinsdale, "American Government.")

Some strict constructionists have held that the permissive clause in the Constitution relating to these laws was only intended to refer to *bankrupts*, applying the word to traders, as under the old English laws. The general interpretation and the now accepted one, however, is that it was the intention of the framers of the Constitution to confer upon Congress authority to legislate upon all the questions of every character and description concerning business collapses, and including voluntary and involuntary bankruptcy.

The first bankruptcy law of the United States was the Act of April 4, 1800, the operation of which was limited to five years. The new Federal Government had been

in existence eleven years before Congress availed itself of its constitutional right to pass a bankruptcy law. One of the reasons assigned for the enactment of this law was the distress caused by the depredations inflicted by England upon our merchant marine, and the feeling gained currency that where general business distress existed the chances of adequate relief, so far as the creditor class was concerned, would be best subserved through the operations of a national statute. This bankruptcy act was based almost entirely upon the English law of that period and was limited to traders only, its benefits being withheld from those not engaged in business pursuits, meaning mechanics, farmers, professional men, clerks, etc. The only exemptions permitted under this act were necessary wearing apparel, bedding for the bankrupt and his family, and bread money. In order that a bankrupt might not be thrown upon the world entirely penniless, with the possibility of himself and his family becoming public charges, a provision based on the old "bread-money" principle of the English law was inserted in the act. Under this, a bankrupt who had complied with all the requirements of the law was to be paid five per cent on the "net produce" of the estate, providing that it realized a dividend of fifty per cent for the creditors; this commission of five per cent not to exceed in the gross the sum of $500. In case the estate was sufficient to pay the creditors seventy-five per cent, the bankrupt was allowed ten per cent, this commission, however, not to exceed the sum of $800. It being the first attempt at bankruptcy legislation, it is not surprising that the law did not prove satisfactory. The pressure brought to bear upon Congress for its repeal was very strong, and a repeal bill was passed December 19, 1803,

so that the first bankruptcy act was not permitted to live its allotted life.

Although the first bankruptcy legislation had not proved satisfactory, either to its friends or to the country at large, shortly after the close of the second war with England there again arose a demand for the passage of a national statute on bankruptcy. This sentiment, however, did not crystallize into any powerful form until subsequent to the panic of 1837. The general impoverishment of the people, largely due to speculation, created a very considerable debtor class, which impressed its strength upon one of the political parties of the period, so that it might be said the law passed August 19, 1841, was adopted in response to a demand of the debtors of the nation. As might have been expected, there was introduced for the first time in American bankruptcy law a provision permitting voluntary bankruptcy, open to all persons whether traders or nontraders. The law was based very largely upon the Massachusetts Insolvency Law of 1838, with the introduction of certain changes suggested by the developments of the legislation in England. Under this act, the exemptions extended to personal property only to the amount of $300. The law excited the disfavor of the creditors of the country, one of the principal grounds of objection being that opposition to a discharge, to be effective, had to be made by a majority in number and amount of the creditors proving debts. It should be said, however, that the law aimed to prevent frequent discharges in bankruptcy, for there was a provision to the effect that a man could not secure a second discharge unless he paid seventy-five per cent of all proved claims; and in this respect, at least, the law of 1841 was decidedly

in advance of later legislation on this subject in the United States.

Another feature of the law of 1841 was the fact that appeals could not go beyond the circuit courts. This was not a wise provision, especially in the incipiency of bankruptcy legislation, for the inability to carry questions to the Supreme Court of the United States would naturally have a tendency to narrow the limits of interpretation to be placed upon the law.

The next effort of any moment to secure bankruptcy legislation in the United States commenced in 1861, but this movement did not assume significance until 1864, when a determined effort was made by Congressman Thomas A. Jenckes, of Rhode Island, who was the special champion of bankruptcy legislation in Congress, to secure the passage of a law. It required, however, three years of almost unremitting effort to bring about the adoption of the Act of March 2, 1867. This law was a much more thorough statute than either of its predecessors. The administration of the law was committed to registers and assignees, the relative powers and duties of whose offices corresponded with those of the referees and trustees under the present act. A wholesome provision of the law of 1867 required that a voluntary bankrupt must owe debts in excess of $300, thus preventing a great number of applications for relief in bankruptcy by those who owed small amounts, representing debts incurred through purchases for the necessaries of life. Under this law appeals to the Supreme Court of the United States were barred unless the matter in dispute exceeded $2,000. The exemptions under the Act of 1867 extended to such personal property as household goods and wearing apparel and equipment

used in the service of the United States, a provision due to the fact that the country had just passed through the great Civil War. There was introduced into the law of 1867 (for the first time) a provision exempting property which would be exempt under the laws of the State of which the bankrupt was a resident, or had his domicile at the time of the commencement of the proceedings in bankruptcy.

The "acts of bankruptcy" under the law of 1867 did not differ in any essential respect from those of the previous laws, a condition of insolvency being understood to apply to a person who had defaulted in his commercial payments. This provision presented many complications, especially during the years of panic following "Black Friday," and so serious did this question become that the law was amended (Act of June 22, 1874) so that an involuntary petition did not lie unless made at the instance of creditors representing one-fourth in number and one-third of the aggregate of provable debts. This change, designed to assist those who might be temporarily embarrassed, and also to make the law more flexible, was one of the principal reasons for its undoing, for under the amendment it was most difficult to have a person adjudicated a bankrupt, and the debtor class was not slow to grasp the advantages which this situation gave them. In addition to this, the expenses of administration were believed by the creditors to be excessive, and although an effort was made at some reform in this direction, through the amendments of 1874, the disapproval which the law had excited became so pronounced as to lead to its repeal June 7, 1878. There were ten amendatory bills passed changing the Act of March 2, 1867.

That bankruptcy legislation had not taken a permanent

hold upon the favor of the people is evidenced by the following opinion of so excellent an authority as Judge Lowell, who during the pendency of the Act of 1867 made this reference to it:

"Whether or not the bankrupt law will take its place as part of the settled policy of the country cannot be easily predicted. It is not likely to be displaced until the existing commercial depression has been relieved. After that time much will depend upon the degree of care and economy with which it is administered, and the readiness of Congress to adopt modifications that shall be found to be necessary, but most upon the opinion that the debtors of the country may entertain of its operation."

It would now be well to consider certain reasons why, up to the time of the repeal of the Act of 1867, bankruptcy legislation had not come to be regarded as a necessary element of our jurisprudence. From the adoption of the Constitution there had existed two powerful political elements, known as Federalists and Anti-Federalists. Federalism represented that type of statesmanship and its following which believed in a strong centralized government, and was wedded to the theory that the best interests of the Union required the exercise of the Federal power in every respect where it could be constitutionally applied. On the other hand, anti-federalism seemed to regard the Union as simply a vehicle for the dispensation of certain authority, but was predisposed to hold within the States the largest measure of autonomy and, where constitutional interpretation was necessary, to limit as far as could possibly be done the scope of the Federal compact. Later these elements came to represent the extremely divergent views held by the Whigs on one side and the States' Rights people on the other. The States' Rights interests had always

viewed with marked jealousy the slightest curtailment of the prerogatives of the States, although Senator Hayne, of South Carolina, one of the most distinguished States' Rights leaders of his day, believed that a national bankruptcy law was preferable to the many State laws affecting debts.

It was decided by the Supreme Court, in Sturgis vs. Crowninshield (the court speaking through Chief Justice John Marshall), that "since the adoption of the Constitution of the United States, a State has authority to pass a bankrupt law, provided such law does not impair the obligation of contracts, and provided, further, that there be no Act of Congress in force to establish a uniform system of bankruptcy conflicting with such laws." This was the strongest incentive to the States' Rights people to uphold and extend the power and authority of the States in respect to the administration of debts, by preventing the passage of a national bankruptcy law.

The fact of State laws being in operation conferred upon State courts the administration of failed estates. No matter what might be the character of the State law, there was vested in the State courts the authority to dispense a large amount of patronage. The question of official and judicial patronage has affected and always will affect the popularity or unpopularity of certain measures of government. Where the power to dispense this patronage is transferred to the United States courts through the operation of a national bankruptcy law, and the State courts thereby deprived of it, jealousies are bound to arise, for it not infrequently happens that this transfer may result in giving the patronage to an entirely different political element from that which may be in con-

trol of the governmental and judicial power of the State. This linking of the judicial power with the political power is not intended as a reflection upon the uprightness or purity of purpose of the judiciary, but it is an undeniable fact that under our political system of selecting judges, they are in honor bound to dispense court patronage among the members of that party to whom they owe the favor of their nominations or appointments. Not only is the political power that this patronage confers involved, but there is also the extremely important question of the emoluments that flow. It is, therefore, evident why certain political elements should very much prefer a system for the administration of debts that leaves all these powers and emoluments within the control of the States and not as a part of the national judicial machinery.

Further, there has always existed among the people an element strongly opposed to extending the authority of the United States courts, and the root of this objection is one that does no dishonor to those holding it, for it is the old differentiation between Federalism on one side and the States' Rights cult upon the other. It may be said for the latter that many of its followers honestly believe that the liberties of the people will be best nurtured by the States holding a strong balance of power, and by keeping the power to govern as near to the people as possible. Under our political system it is the theory that as a municipal government was closer to the people than a State government, so, naturally, was a State government closer to the people than the national Government.

There has also existed another ground of objection to bankruptcy laws. It is the theory that when a man goes through bankruptcy his misfortunes are unduly exploited

or made a matter of greater publicity than would be the case if he were simply to make an assignment under a State law. There is some reason for this. Although assignments under State laws are usually advertised at the time they are made, the administration of an assignment is practically a private one, whereas, under the Act of July 1, 1898, a bankruptcy case must be a matter of public record. Indeed, it is the publicity made necessary by the provisions of the statute that constitutes a strong point in its favor. The title "bankrupt" has always been used as an opprobrious one, due undoubtedly to the fact, as before stated, that under the first English laws, bankrupts were supposed to be persons who had committed grave offenses against their neighbors and the state, through the very fact of being unable to pay their debts; and under the Continental systems bankrupts were under certain conditions treated with great severity; in fact, made to wear a certain garb to advertise their disgrace and add to the contumely of their situation. Naturally much that is objectionable has always surrounded the name, and this has in past years accounted to some extent for the disfavor with which bankruptcy laws have been regarded, although De Tocqueville remarked on the strange indulgence shown to bankrupts in the United States.

The great industrial revival subsequent to the panic of 1873 marked the transition from the formative to the constructive period of the nation's existence, and it is beyond question that the most powerful element in this great constructive process has been the spread of commerce. As the trade and commerce of the nation have expanded, the usages, political sentiments, and national aspirations of the people have undergone a stupendous change, and the

full effect of this change is manifested in the stirring demand for everything that will enhance the prestige of the Government as a great national entity. It was indubitable that State lines, State limitations, and the narrowness due to certain phases of State pride should disappear or be ground to nothingness under the triumphant heel of the giant of nationalism.

As an accompaniment of political changes, there arose a persistent demand for the adoption of a new national bankruptcy law, and while it may be said that the effort to secure such a law was commenced almost immediately after the repeal of the law of 1867, it was not until the middle of the last decade of the nineteenth century that this movement had assumed such proportions as to attract the earnest attention of Congress.

Behind this demand for a new bankruptcy law there was marshaled the great bulk of the commercial interests of the country, no longer a secondary influence, but in the march of events an element that had become a controlling spirit in affairs. Aiding in this work for many years was the press of the country, which had always taken a favorable view of national bankruptcy legislation. As opposed to the passage of a new law, there were certain powerful interests represented by the bankers, a few very large mercantile institutions, and the remnant of the States' Rights contingent. This opposition was effectual for some years, but it was finally borne down, through the tenacity of the friends of a national law for the administration of debts, by the passage of the National Bankruptcy Act of July 1, 1898.

The present National Bankruptcy Act was enacted after a struggle prolonged for nearly twenty years. As an

illustration of the doubt existing in the House of Representatives as to the wisdom of this legislation, a motion to limit the operations of the law to three years was only defeated by a close vote. The passage of the act was hailed by a majority of the creditors of the country as a progressive step in legislation affecting the relations of debtor and creditor. It was not considered, even by its friends, to even approximate a perfect measure, for in reality it was a compromise between the forces favoring a comprehensive bankruptcy law and those who favored a purely voluntary and discharge measure. It was hoped, however, that the law would prove to be the beginning of permanent bankruptcy legislation.

The act as it left Congress was certainly the best thought-out bankruptcy legislation that had ever been placed upon the statute books of this country. While the range of its operations may not be as extensive as some of the European laws, it is a well-constructed and readable measure. One of its elements of superiority is the ease with which references to its different sections may be made. This is very important in a measure so close to the everyday life of the people, for unless a law be well phrased and its different divisions clearly indicated, it is not to be wondered at if the people fail to appreciate its character and scope.

The administration of the law of 1898 was received by its friends with incomplete satisfaction from the beginning. The all-time opponents of bankruptcy legislation, perceiving the manifest deficiencies of the statute, promptly commenced vigorous attacks upon it. They offered as one of their strongest arguments the dissatisfaction of its friends, and advanced the theory that it was impossible

to devise an acceptable national bankruptcy law. The ease with which discharges were secured (some men securing several discharges within a few years) showed that the law was lamentably weak in this respect, and that unless some effort were made at amendment, its repeal was certain; in fact, so excellent an authority and able and constant a friend of the bankruptcy law as Mr. William H. Hotchkiss, of Buffalo, said in an article published in the *North American Review* of April, 1901, on "Two Years of the Federal Bankruptcy Law":

"The law, then, should either be repealed or amended. Already some are clamoring for repeal. The 'jubileeists' demand it on principle; our mighty crop of tares having been garnered, the purpose of the law, say they, has been fulfilled. These err in understanding, not motive. The same cannot be said of a less numerous but very powerful class who seek its repeal. The past two years have witnessed association after association of bankers fulminating against the law. Scarce a week passes but the heads of certain great mercantile establishments declare publicly that it must go. Even many lawyers charge a present decrease in litigation, amounting to a quarter or a third, to the existence of this statute. The three together have raised such a clatter that repeal bills are pending in both houses of Congress.

"But, should the law be repealed? Not, surely, because self-interest, nourished by the memory of secret preference and unfair advantage, rises like a banshee to warn the one-time preferred that its repeal would be profitable to them. Those who have not been able to command preferences, or to support collection bureaus, or to increase sales by subsidizing employees, are at last safeguarded by the law. Nor should it be repealed on the ground that it is wrong for the State to cancel debts. The interests of the State are ever greater than those of the individual. More, it should not be repealed, because, once repealed, the nation will bid farewell to all bankruptcy legislation until panic leaps through the land and furnishes an excuse for another jubilee. Meanwhile, the business

world would be back again where it was three years ago, scrambling for precedence, the strong crushing the weak."

The demand for radical amendments to the law commenced within a year from the time of its passage and was maintained with great vigor. Many repeal measures and amendments were introduced in Congress. The most important amendments were those contained in the Ray Bill, which took its name from Hon. George W. Ray, chairman of the Judiciary Committee of the House of Representatives in the Fifty-seventh and Fifty-eighth Congress, afterwards a United States district judge. After some delay and some important changes in the Senate the Ray Bill was passed, and went into effect February 5, 1903.

The bankruptcy act is divided into seven divisions or chapters, viz.: Chapter 1, Definitions; Chapter 2, Creation of Courts of Bankruptcy and their Jurisdiction; Chapter 3, Bankrupts; Chapter 4, Courts and Procedure Therein; Chapter 5, Officers, Their Duty and Compensation; Chapter 6, Creditors; and Chapter 7, Estates. These chapters are separated into many subdivisions. The act aims to reach every contingency of bankruptcy administration, based on the principles of substantive law. While many believe that it should be more rigorous, Congress undoubtedly pursued the wisest course in not adopting a too drastic measure, especially as far as it might relate to the requirements of criminal or remedial law.

A marked departure in bankruptcy legislation appears in Subdivision 15, Section 1, Chapter 1, viz., the definition of insolvency. Under the Act of 1867 and other statutes, and especially the Continental statutes, a failure to meet one's liabilities as agreed was an act of bankruptcy.

It appeared, however, to the framers of the present act that it would be better, especially in view of our great commercial activity, to define insolvency by a much narrower interpretation. It is provided that:

> "A person shall be deemed insolvent within the provisions of this act whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, or removed, or permitted to be concealed or removed, with intent to defraud, hinder or delay his creditors, shall not, at a fair valuation, be sufficient in amount to pay his debts."

According to this interpretation, it is more difficult to place a man in bankruptcy than under the other method. The debtor is regarded as the weaker party, and it was no doubt the design to protect him from radical action by his creditors. There is no danger, under the present act, of a man being declared an involuntary bankrupt unless his condition be such that the creditors can prove beyond doubt that his estate is unable to satisfy the liabilities against it. As an additional protection to the debtor, the law provides that where an involuntary petition is filed the alleged bankrupt shall have the right to ask for a jury trial to determine his solvency.

The act provides for voluntary and involuntary bankruptcy.

> "Any person who owes debts, except a corporation, shall be entitled to the benefits of the act as a voluntary bankrupt. Any natural person, except a wage-earner, or a person engaged chiefly in farming or the tillage of the soil, any unincorporated company, and any corporation engaged principally in manufacturing, trading, printing, publishing, mining, or mercantile pursuits, owing debts to the amount of $1,000 or over, may be adjudged an involuntary bankrupt."

A feature which is regarded with disfavor by the creditor interests is that which permits a debtor whose estate is administered in bankruptcy to avail himself of such exemptions as are allowed in the State wherein he has had his "domicile for the six months or greater portion thereof immediately preceding the filing of the petition." There exists as marked a diversity in State legislation on the subject of exemptions as on every other question, and the unfairness of this provision is manifest. The difference in State exemptions has also been urged by the opponents of a bankruptcy law as an argument to prove that it is not a uniform measure, as it permits a diversity of exemptions. As a constitutional proposition, however, this has not been regarded as a tenable objection, and consequently has never been construed as affecting the uniformity required by the Constitution in the authority conferred upon Congress to legislate on bankruptcies.

Among the best features of the act is one which permits compositions with creditors, even after a person has been adjudicated a bankrupt. The question of the composition comes directly before the court, and the power to make it enforceable is discretionary with the judge. If he considers that the composition offered is to the best interests of the estate, he can order it made, irrespective of the feelings of a very powerful minority of the creditors. This is an essentially humane provision. The lodgment of this authority in the judge protects a well-disposed bankrupt from the rapacity of creditors who, taking advantage of his desire to continue in business, attempt to force from him one hundred cents on the dollar. Compositions may be set aside by the judge if it can be shown that fraud was practiced in their procurement.

One of the most important provisions of the bankruptcy law is the discharge feature. A bankrupt who has complied with all the requirements of the statute may receive a complete discharge from his debts. This is the great boon sought by those unable to pay their obligations in full. The grounds of opposition to a discharge are as follows:

"(1) Committed an offense punishable by imprisonment as herein provided; or (2) with intent to conceal his financial condition, destroyed, concealed, or failed to keep books of account or records from which such condition might be ascertained; or (3) obtained property on credit from any person upon a materially false statement in writing made to such person for the purpose of obtaining such property on credit; or (4) at any time subsequent to the first day of the four months immediately preceding the filing of the petition transferred, removed, destroyed, or concealed, or permitted to be removed, destroyed, or concealed any of his property with intent to hinder, delay, or defraud his creditors; or (5) in voluntary proceedings been granted a discharge in bankruptcy within six years; or (6) in the course of the proceedings in bankruptcy refused to obey any lawful order of or to answer any material question approved by the court."

There are certain classes of debts from which a bankrupt is not relieved by a discharge, and these are represented by:

"Such as (1) are due as a tax levied by the United States, the State, county, district, or municipality in which he resides; (2) are liabilities for obtaining property by false pretenses or false representations, or for willful and malicious injuries to the person or property of another, or for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female, or for criminal conversation; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor if known to the bankrupt, unless such creditor had

notice or actual knowledge of the proceedings in bankruptcy; or (4) were created by his fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity."

The administration of the law is reposed in two sets of officers, known as referees and trustees. Referees are appointed by the judges of the United States district courts; their powers are judicial, and extensively so. Trustees are those elected by the creditors to take charge of a bankrupt estate, a majority in number and amount of provable claims being necessary to effect the election of the trustee. Where creditors cannot agree upon a trustee, the referee may appoint him, his action, however, being reviewable by the district court. Referees are required to furnish bonds in not more than $5,000; the amount of the bond to be furnished by the trustee is fixed by the creditors. If the creditors should fail to do this, the court is authorized to do so.

The strongest merit of the bankruptcy act is the authority vested in the creditors. They are the arbiters as to practically everything that shall be done in the administration of a bankrupt estate. They elect the trustee, fix his bond, pass on almost every question that is presented, and, best of all, they may examine the bankrupt. This examination of the bankrupt is one of the salient points of the law. It enables creditors to learn from the bankrupt under oath exactly how he has managed his business. While no provision of this character, however drastic, will overcome perjury, still in this way a creditor can secure the information which he should have before signing a composition or determining whether he should oppose the

discharge of the bankrupt. In this and numberless other respects is evinced the great advantage of the bankruptcy act over State procedure. If creditors are watchful of their interests it is an impossibility for an estate to be dishonestly administered. The law contains provisions for keeping a creditor well informed, and no meeting is legal for which notices have not been sent; ample time is provided in respect to such notices.

The greatest evil from which commercial interests suffered in the absence of a national bankruptcy law resulted from the practice of insolvent debtors preferring certain creditors. The system of preferences is not only sanctioned, but encouraged, by the laws of many of the States. It may be asked why a State is not disposed to be as just in its treatment of creditors as Congress would be. The reason is obvious. State laws for the administration of debts are enacted in the interests of home creditors, viz., those residing within the State. The citizens of a State consider that if it is possible to secure any advantage, they are entitled to it, even though it may be an undue advantage over those who reside and do business out of the State. Further, a home creditor has an advantage over a creditor residing in another State, as he is able to watch a debtor at closer range, the element of contiguity being in his favor and enabling him to quickly detect unfavorable conditions in the debtor's affairs. The ability to acquire unfavorable information more promptly than could an outside creditor would prove of little value unless residents were advantaged under the law. This recompense has been given to them through laws that enable home creditors to expeditiously attach the effects of the debtor, secure mortgages, bills of sale, or profit by many of the

devious methods that are the offspring of the preferential system. Preferring home creditors is the idea underlying the system of preferences, although its practice has not been confined to favors extended to them, but has been persistently invoked in behalf of creditors foreign to the State, primarily those who have extended large credits. This system constituted the groundwork of much injustice, and its pernicious effects impelled the creditors of the country to ask for a national law that would suspend the State preferential laws and place all creditors, large and small, influential and humble, powerful and weak, upon the same basis.

In order to meet this essential question, the bankruptcy act provides that if a debtor while insolvent has given a preference within four months before the filing of a petition in bankruptcy, or after the filing of the petition and before the adjudication, the effect of which was to give any one of his creditors a greater percentage of his debt than any other creditor of the same class, all such preferences shall be voidable. It is generally assumed that a man's insolvency dates, not from a few days prior to his application to be declared a bankrupt or the filing of an involuntary petition against him, but that insolvency is a matter of gradual development. Experience has shown that even after a man may know that he is insolvent, he makes an effort, and very often a heroic one, to overcome this condition, but without success. Therefore, the law presumes that a condition of insolvency has prevailed for some time, and in order to reach all cases where preferences may have been given during the probable term of such insolvency, *four months* has been prescribed as the period during which preferences, if given, may be voided.

Such, in brief, is the scope of the National Bankruptcy Act of 1898.

In their earlier functions bankruptcy systems were creditors' laws. The broadening of their scope has conferred their benefits upon debtors as well as creditors. While the laxity of certain provisions of our present statute may result in dishonest debtors reaping unjust gains at the expense of their creditors, these cases are exceptional. The opportunities to prey upon creditors will disappear as the necessity for strengthening the law makes itself evident, and such changes as are required will be incorporated in the act.

The following have been cited as the principal advantages resulting to the people from the administration of the present bankruptcy act:

1. "The prevention of preferences."

2. "The excellent influence of the law in enforcing concert of action and mutual terms of settlement without recourse to legal proceedings."

3. "The expeditious adjudication of bankrupts, as distinguished from the tedious and expensive processes common to State courts."

4. "The election of the trustee by the creditors."

5. "The examination of the bankrupt by creditors."

6. "The adjustment of bankruptcies through compositions with the knowledge and under the direction of the court."

7. "The prompt administration of estates and an avoidance of the usual vexatious delays in litigation."

8. "The use of contempt proceedings to effect the recovery of property."

9. "The institution of ancillary proceedings to reach property lying in different States."

10. "The sale of real estate clear of liens."

11. "The settlement of the affairs of corporations in bankruptcy in the interests of creditors and stockholders."

12. "The reduction in expenses incident to failed accounts, notably in the case of attorneys' fees."

13. "The acquirement of increased dividends from insolvent estates."

14. "The punishment of fraudulent bankrupts."

15. "The administration of insolvent estates wholly in charge of the creditors interested."

The student who inclines to the States' Rights theory may ask if it is not possible to secure all these advantages under the operations of the State system, or whether the States cannot legislate quite as forcefully in the interests of creditors as Congress. The answer is that the States could do so if they desired, and an absolutely uniform law could be adopted by all the States; but even assuming that every State had the same insolvency law, the operation of such a law in the State of Kansas would not be controlling upon the actions of a creditor residing in the State of Nebraska; for it is a settled principle that the laws of a State have no extraterritorial effect.

Our experience under both the Articles of Confederation and the Constitution has shown that the States have no disposition to frame legislation on uniform lines. The habits and proclivities of the people of the several States are as distinctive as those of the people of different nations. That no uniformity of State statutes is probable is conclusively proved by the existence of the present State statutes on the subject of bankruptcies and insolvencies. There are no two States that have exactly the same system, and the time may never come when such uniformity will be followed.

"It certainly cannot be claimed that any benefit arises from this comparison and contradiction; that the rights of either creditor

or debtor are subserved thereby. Among absolutely independent and sovereign nations, there will, of course, be more or less diversity of municipal laws; and persons engaged in foreign trade and commerce must necessarily be put to some inconvenience. But even among independent nations the tendency of the present age is to assimilate their systems of commercial and mercantile law. Among the several States of the Union this diversity, and its accompanying inconvenience, need not exist. The Constitution confers upon Congress full power virtually to ordain one set of rules governing the relations of debtor and creditor throughout the whole extent of the country. The 'uniformity' permitted by the organic law would render a discharge in one State binding in all others; would establish the same acts and defaults of the debtor as occasions for bankrupt proceedings in every section; would abolish the iniquitous privilege of making preferential assignments; would enable the merchant in New York or Philadelphia who sells on credit to a trader in Illinois or Kentucky, to feel certain that when the time for payment should arrive, his debtor would not have failed, and placed his assets completely beyond the reach of the deceived and exasperated creditor." (Pomeroy, "An Introduction to the Constitutional Law of the United States.")

It is the fundamental, inherent, unavoidable, and uncontrollable features of our system of State government that utterly disparage the probability of the States framing laws that will be equally and justly operative toward the citizens of the entire country without respect to the State of their residence, that renders a national law necessary. This sentiment constituted the principle that moved the people to ask for the enactment of the present National Bankruptcy Act, and it is upon this same principle that there is based the demand for a permanent national bankruptcy system. Public policy, commercial security, and the stability of credit are the foundation stones of this demand.

# CHAPTER XIX

## THE EFFORT TO SYSTEMATIZE PROTECTION FROM CREDIT LOSSES—CREDIT INSURANCE

Credit losses are a corollary of the credit system. The proposition has been submitted that if there were no credit there would be no debt, and it is recognized that the extension of credit carries with it the certainty of losses from uncollectible accounts. Wherever credit has been given, losses have followed. The test of the premise that losses are an inevitable result of giving credit, is afforded in the experience of any concern for a given number of years; and the averages of this experience prove that bad debts baffle the prescience of the credit man and the best developed systems of credit-office administration. Losses may be greatly minimized through efficient management, but the intangible forces that enter into credit transactions disparage the complete avoidance of credit losses.

The credit man's objective point is the reduction of losses to a minimum. When he succeeds in holding bad debts within a percentage regarded as a normal loss in his trade, without unduly restricting sales, he exhibits the type of ability necessary in credit work. A moderate percentage of credit losses is regarded as a certainty, to the same extent as depreciation in the value of goods is expected. These two elements of loss are looked for in every

commercial calling, and provision made to cover them by adding to the selling price of all goods the percentage of loss the firm will normally sustain from these causes. This method, which is a system of insurance, results in an added cost to the consumer; so that, as an economic proposition, the entire human family is charged with the fortuitous losses of commerce.

Credit losses being regarded as a certainty, it is natural that efforts should be made to protect the losers. Losses from fire, marine disasters, accidents to life, and other causes, occur with a regularity that enables those interested to compute with reasonable accuracy the average losses due to them in a stated period. A commercial enterprise may suffer a loss from fire only once in a long career; it may never have such a loss; but if it be doing a credit business, there will in all probability be losses from bad debts every year. The question arises, Why should not the same care be taken to protect sufferers from credit losses as to compensate for losses from fire and other casualties, which are the result of the negligence, ignorance, and moral delinquency of individuals, or the disturbances of nature? The means suggested for doing this are comprehended in credit insurance.

Are credits susceptible to the operations of the principles of insurance that apply to all other elements in which there is an appreciable hazard? The first question to decide is, "What is an insurable risk?" It is defined thus:

"An insurable risk . . . is, (1) any chance of loss depending on the occurrence of any uncertain event . . . provided (2) there are sufficient data to enable the degree of probability to be estimated, and provided (3) it is of such a nature that the insured

cannot too easily make use of the insurance for his own economic advantage."

(1) The chances of loss in credits depend on uncertain events; that is to say, the character of the losses is not always the same; their frequency is not always the same; at times they are of slight degree, and at others are augmented. They are uncertain events.

(2) Is there sufficient data to scientifically estimate the degree of probability of loss? There is sufficient data, and it may be acquired; but whether any positive attempt has ever been made to do so is improbable. The statistics of losses published by the mercantile agencies are no doubt accurate statements of the losses of which the agencies have cognizance; but there are losses in credits of which the agencies never know anything. Therefore these statistics are not conclusive as to the full import of credit losses. There are accounts dragged along from year to year, in the hope that something may be realized from them, until the debtor quietly goes out of business, and these debts are buried in the deep bosom of the profit and loss account.

Further, What of the vast losses that take place in individual credit? What is known of their extent? a subject to which attention was called in the chapter on "Individual Credit." The element of hazard figures in all branches of credit. If transactions of one division are subject to insurance, so are the transactions of all. It will be said that the plan upon which credit insurance is operated answers the first two objections, for the reason that the indemnity is based on a firm's statement of all its losses for a period of years, and that in this statement will be included all losses, whether they are the result of specific

and publicly reported failures, or the losses due to dry rot. It is true that this is the system followed, but who will attempt to say that this basis is as scientific as that on which fire and marine losses rest? In the latter the average losses have been determined by means that are subject to public knowledge. The losses are determined by expert and impartial appraisement. If there is a usufruct of salvage it is considered in the approximation of the average losses. Credit insurance, up to this time, has made but the barest attempt to reduce the question of the "degree of probability" to the same scientific basis followed by the other branches of insurance. The fact that credit-insurance premiums have trebled since it was first instituted proves that it has been an experiment solely. The tendency of fire-insurance rates has been downward, showing that the refining process which has been applied to the methods controlling that branch of insurance have made for a reduction in the cost to the assured, although there is no doubt that well-managed fire-insurance companies have been paying enterprises.

Credit insurance as practiced does not aim to indemnify a man to the full extent of his losses, but only to reimburse him on account of what is called his *abnormal loss*—by which is meant that amount of losses which exceeds his average or "own" loss. A certain percentage of "own" loss is established, based on the average losses of a firm for a given number of years. As an example, we will consider a business whose sales reach $1,000,000. The average loss has been one-half of one per cent for a period of five years. Credit insurance requires that when a man takes out an insurance policy he must first lose the average or "own" loss of, say, one-half of one per cent before

he can call upon the insurance company for relief; for instance, his policy is $15,000 and his own loss $5,000; if he should lose only $5,000 during the year in which the policy is in force, he would have no claim upon the company; if he lose $10,000, he can prove his claim to the amount of $5,000. If his losses were $17,000, he could prove only to the extent of $10,000, the difference between his own loss and the face of the policy. But why this own loss at all, if credits can be insured? Reasons have been advanced to justify it—some plausible, others fanciful. It is urged that as a man always expects to have a certain percentage of losses, he provides against them by adding a percentage to the selling price of goods, and his customers thus reimburse him for the loss; that what he loses above this figure is abnormal and unprovided-for loss. If a merchant's customers reimburse him for his average loss, then in effect he has no loss at all, and his bad debts are simply debited against his merchandise account. Assume that he has an unexpected loss during a year, raising his losses from one-half of one per cent to one per cent, why can he not add an increased percentage to the selling price of his goods? What simpler system of insurance? If it is scientific to add the percentage of his average or "own" loss to the selling price of goods, it would be equally scientific to increase the rate. Ah! but some one says, he *knows* what the average loss is, but he does not know what the abnormal will be. The average, if it be a correct average, must comprehend the abnormal, and can be computed from year to year.

It may be asserted in answer to this, that where goods are sold upon a close margin it would not be possible to add anything to the selling price over a very moderate or

normal percentage, to cover losses from bad debts, without unduly increasing the price, and thus inviting inability to make sales. If the addition of a percentage sufficient to cover such losses is not feasible, then the "own" loss theory is a fallacious one. Take the case cited where losses had been increased from one-half of one per cent to one per cent; a concern is carrying credit insurance as practiced, and has been assuming an "own" loss of one-half of one per cent; it charges this to the selling price of goods; the following year, however, its losses are one per cent. The policy of the credit-insurance company will be to increase the "own" loss, and unless the merchant submits to the increase to decline to write a new policy. Assuming that the merchant surrenders, how is he going to dispose of his increased "own" loss? He must add it to the selling price of goods.

The failures reported by Messrs. R. G. Dun & Co. for the year 1904 in commercial circles amount to $144,202,311. These figures include the "*own*" and abnormal losses, but do not comprehend the losses occurring from accounts that are not listed among the reported failures as before described, or the losses occurring in "individual credit." The point to be considered is this: Whether this amount of $144,202,311, including as it does the "own" losses, is susceptible to the operations of insurance. If it is, then the "own" loss theory is an untenable one. Would the cost of sustaining this amount of insurance prove too great a strain upon the commercial interests of the country? If it would, then credit insurance is not feasible; if it would not, then credit insurance is entirely feasible, and the "own" loss theory again falls to the ground.

An advocate of credit insurance says, while defending the "own" loss principle:

"It would be folly to demand that the Indemnity Company should underwrite the full loss in a year, as no company could withstand the $160,000,000 of losses per annum which occur from bad debts in this country."

This statement would move one to ask why, if credit insurance is analogous to fire insurance (and it is generally claimed to be so), insurance companies should not be able to withstand the loss of $160,000,000 per annum in credits if they are able to stand losses of $141,000,000, the amount actually paid by the fire-insurance companies in 1904. The figures of $160,000,000 are evidently reported liabilities, but there must be deducted the assets of the estates represented. For instance, although the liabilities from commercial failures reported for 1904 were $144,202,311, there were assets reported in these failures of $84,438,076. These assets are undoubtedly subject to considerable scaling, as the figures are no doubt taken from the first reports of failed estates and are not the actual amounts realized from the sales of property and the collection of accounts; so that the liabilities of $160,000,000 per annum do not necessarily mean that credit-insurance companies would have to pay out this amount. The payments made by the fire-insurance companies in the year 1904 prove that the amount that must be paid is not the only important consideration; the economic accuracy of the plans and the universal distribution of the risks involved being necessary elements of correct insurance. When one considers the gross capital employed in business, or the gross amount of business transacted, the figures $144,202,311 need cause no consternation.

It will be evident without any long mathematical demonstration that the commercial interests of this country are fully able to bear the expense of insuring losses. If a system can be devised which will insure credits within reasonable limitations, then it will not be necessary to add to the selling price of goods the percentage or ratio of failed accounts included in the "own" loss class, and the cost of goods to consumers will be reduced to that extent. Even assuming that there is never any necessity for increasing the "own" loss percentage in computing the price of goods, there is an item which must be added to the selling price, and that is the cost of the credit insurance. This cost is a legitimate expense, if it be proper to carry credit insurance at all. When these two items, "own" loss and "cost of credit insurance" are considered together, as they should be, the question immediately arises as to the business wisdom of the outlay, this depending entirely upon the economic utility of credit insurance, its scientific operation, and its adaptability to the special line of business.

It may be said that in the last analysis there is no difference between charging the "own" loss account to the consumer or increasing the expenses for insurance. The question upon which we are working is whether credits can be insured, and if it is not feasible or proper to insure what are called "own" losses, that question might just as well be settled and credit insurance given its right name, which would probably be, "insurance to cover extraordinary losses in credits." You must make somebody else pay your "own" losses. Further, the "own" loss theory must not be confused with the principle of coinsurance.

Spreading risks among a very large number of persons

minimizes the degree of risk in each particular case, and reduces the cost of insurance to each individual.

The insurance of credits must of necessity be regulated so as to prevent recklessness in the extension of credits. Credit givers should not be permitted to take extreme chances, feeling that they would be able to recoup themselves through credit insurance, or "to easily make use of the insurance for their own economic advantage." Recklessness in giving credit with a view to such protection would defeat the very idea upon which insurance as an abstract proposition is grounded, and no system of insurance could obtain for any length of time where the assured was not governed by certain specific rules in his management or care of property (credits are property). This idea has been approached by those selling credit insurance, in the restrictions imposed upon the assured as to the limits of accounts that will be provable under the policies. These limits are based upon certain percentages, either of the capital ratings of those to whom goods are sold by the assured, or percentages of the business done, where policies are written upon the experience plan. Adherence to these restrictions has made for safer credits.

The second most important consideration arising in credit insurance is the accomplishment of the largest possible saving from doubtful and failed accounts. No system of credit insurance is adequate that does not comprehend the control of all doubtful and failed accounts which are provable under the policies. For the information as to the exact status of these accounts, credit insurance has depended upon the mere statements of the assured or attorneys representing them. There is no doubt that in a very large percentage of cases reports made as to the conditions

of these accounts are correct, *according to the belief of the assured or their representatives*, but the weakness of the system consists in this, that these accounts have not been under the direct charge of the insurance companies, who have not been in a position to know whether everything that could possibly have been done to save an account, or a portion of it, has been accomplished. Sending an account to an attorney, having him investigate it and report that it is uncollectible, then reducing it to judgment, or seeing it wiped out by the discharge of a bankrupt, is not the most scientific way of saving accounts.

The purpose of credit insurance should be largely preventive against losses. When the time arrives that the very fact of an account being in a doubtful condition will warrant reporting it to the credit-insurance company, and the majority of those interested in the case invited to concert of action, then a practical prevention of losses will take place. Such accounts can be thoroughly treated and estates administered with slight expense; businesses saved that might have been ruined through individual action on the part of creditors, each suspicious of the other; and men saved from bankruptcy because intelligent action will protect them from this fate. All this is just as legitimate a function of credit insurance as the control of damaged property by fire-insurance companies or the assumption by a fidelity company of a claim against an embezzler. The system which will avoid failures, administer embarrassed estates with a minimum of expense, and reduce the expense incident to failed estates, will be a real system of credit insurance, for its purpose will be not only to reimburse against losses but to reduce the expenses of such insurance by the avoidance of losses. Doubtful or failed accounts

should be adjusted by the adjuster of the credit-insurance company. The object of such adjustment is not to provoke litigation, but to avoid it; not to act as a mere distributor of collections to commercial lawyers, as the object to be gained is a decrease and not an increase of expenses. It is to the interests of the credit-insurance companies to see that the stock of a failed business brings the highest possible figure, and to prevent if possible the wasting of its value through an ordinary bankrupt sale.

The principles upon which credit insurance should rest are (1) protection against all losses incurred, and (2) the conservation of the assets of embarrassed estates. Credit insurance has been a much discussed subject; but it would appear that too much of the discussion has hinged on the interpretation of the phraseology of the policies and the difficulties encountered in making satisfactory adjustments when the credit man has attempted to prove a loss.

Credit insurance, founded upon scientific bases, with the degree of probability of loss worked out to a scientific demonstration, providing for the conservation of estates under such auspices as have been indicated, as an item of expense reduced to the lowest possible figure commensurate with due protection to the assured and a fair return on the investment to the insurance company, will be a safeguard to credit giving and a stimulus to commerce.

# CHAPTER XX

## ORGANIZATION AND EDUCATIONAL MOVEMENTS IN CREDIT

### (A) ORGANIZATION FOR THE IMPROVEMENT OF CONDITIONS AFFECTING CREDIT

ORGANIZED efforts for the improvement of conditions affecting credit were instituted in the year 1896. This movement was the outgrowth of discussions which took place at the World's Mercantile Congress (June 19–26, 1893), held under the auspices of the management of the great Chicago Exposition. The announcement of this congress contained the following statement: "It is hoped that this congress may be the means of laying the foundation for permanently organized effort for the better regulation of mercantile credits in the future." Among the questions which it was proposed to discuss were the following:

"How can we raise the standard of credit, reduce its dangers and losses, and at the same time extend and increase its usefulness to ourselves and others?"

"How can the quality of information concerning debtors and the present facilities for obtaining it be improved?"

"Would it be practicable, through coöperation, to establish a standard of requirements for credit basis?"

Toward the close of this congress a resolution was adopted for the appointment of a committee to organize a national association; but nothing was done through this

channel. Three years after the Mercantile Congress had met, the National Association of Credit Men was organized at Toledo, Ohio. Prior to this, credit associations were formed in a few cities, and these so-called local organizations were the nucleus of the national movement. There had been credit companies, or bureaus for the exchange of credit information and the collection and adjustment of accounts, in existence for a number of years; but the National Association of Credit Men was the first body that ever successfully attempted to accomplish an improvement in the conditions surrounding credit based upon ethical and educational purposes. Its objects are as follows:

"The objects of this association shall be the organization of individual credit men and of associations of credit men throughout the United States, in one central body, for the purpose of rendering more uniform, and establishing more firmly, the basis upon which credits in every branch of commercial enterprise may be founded, which shall include a demand for a reform of the laws unfavorable to honest debtors and creditors, and the enactment of laws beneficial to commerce throughout the several States; the improvement of existing methods for the diffusion of information, the gathering and dissemination of data in relation to the subject of credits; the amendment of business customs, whereby all commercial interests may be benefited and the welfare of all may be advanced; the provision of a fund for the protection of members against injustice and fraud, and such other objects as the members of this association may determine upon."

It will be observed that the aims of this organization conform very closely to the statement of purposes issued in behalf of the World's Mercantile Congress.

The credit-association movement has been a progressive one, judged by the constant accessions to its membership and the activity displayed in developing its intents. Its

greatest success has been in the establishment of friendlier ties between business men of all sections, accompanied by a more pronounced and satisfactory diffusion of credit information. Through its efforts there has also been a gratifying advance in the procurement of legislation, making for more equitable relations between debtors and creditors, and restricting the possibilities of frauds upon creditors. The question of "rendering more uniform and establishing more firmly the basis upon which credits in every branch of commercial enterprise may be founded" is generally recognized as hardly being susceptible to any definite regulation, and the best that the credit associations can do is to cultivate among business men a higher appreciation of the rudimentary obligations which attach to the dispensation of credit, and promote adherence thereto.

As an educational center for credit men, the credit association has been a very important factor. The members have been encouraged to express their views upon credit and business problems through the medium of its publications, and in this way a fruitful source of credit literature has been developed. This is represented by articles, addresses, and pamphlets published through the Business Literature Department of the National Association of Credit Men. These writings are in almost all cases the work of business men. As Irving has said: "The inventions of paper and the press have put an end to all . . . restraints. They have made everyone a writer, and enabled every mind to pour itself into print and diffuse itself over the whole intellectual world." There is included in this collection certain addresses made at meetings of the credit associations by judges, lawyers, and public officials on questions pertinent to some phase of the credit problem. These writings

cover a wide field and relate to the following general questions:

Accounting and Bookkeeping.
Banks, Bank Credits, and Related Questions.
Bankruptcy Law.
Business Abuses.
Business Principles and Customs.
Credit.
Credit Men and Credit Associations.
Credit Insurance.
Credit Lines and Limitations.
Credit Instruments.
Collections and Their Management.
Competition.
Coöperative Credit Information.
Educational Training for Business.
Elements of Credit.
Exemption Laws.
Business Depressions, Failures, Assignments, etc.
Fire Insurance and Its Relation to Credits.
Fraudulent Practices.
Legal Aspects of Credit Transactions.
Mercantile Agencies and Ratings.
Retail Credits.
Salesmanship and Its Relation to Credits.
Statements Reflecting the Financial Condition of a Business.
Trade Conditions.
Terms, Datings, and Discounts.
Wholesaling and Jobbing.

## (B) THE STUDY OF CREDIT

The tendencies of the age being strongly directed toward specialization, it is necessary that the student or the practitioner should apply himself to a distinct study of the particular branch of business he expects to follow

or is following. The universities, colleges, and schools have apprehended the need of an extension of their curriculums to meet this demand of the times. It has been noticeable that since the organization of the National Association of Credit Men and the interest in the study of credit that it has stimulated, many institutions of learning have been devoting considerable attention to the subject of credit. It does not appear that credit has been made a separate feature of any of the courses in commerce, finance, or business administration conducted by the different universities and colleges, its interrelationship with money and banking making it more a division of the department of political economy. The treatment of credit in these courses relates to a study of its principles and general purposes.

An examination of the studies included in the courses referred to shows that it is the judgment of the scholastics that an understanding of the higher branches of business activity must be accompanied by an appreciation of the fundamental principles upon which a question rests, considered in the abstract and historically. For instance, it is not presumed that all a man needs to fit him for the profession of banking is to first carry messages, then become a bookkeeper, and finally to be promoted to an officership; nor for a credit man simply to pass through the routine of a credit office. There is a certain training which should be applied to the mind, and which can only be acquired through a study of a subject from its first principles. It is agreed that this training is largely "disciplinary," but it makes for a much better comprehension of any question, and assists that "accuracy of thought" and "clearness of expression" so essential to a well-developed business

experience and judgment. The student of credit must therefore discipline his mind by a proper study of the economic bases upon which credit stands. Economics has, up to this time, played too small a part in the thoughts of the business world. Credit men, by virtue of their vocation and the duties it involves, should be foremost in demanding that not alone the superficial, but the innate and fundamental character of all questions should be studied and appreciated, and a halt be called on the idolatry of the practical to the exclusion of underlying and eternal precepts. There is a delusion that "knowledge fetters genius," especially that character of knowledge obtained from books. Frequently men who have had only business training scoff at suggestions which may be the outgrowth of "courses in commerce" and information derived from economic treatises or teachings.

Credit involves an analyzation of the character of man and the values of properties of all descriptions. Economics covers the status of man in society; and therefore if the credit man is to measure with correct judgment the elements that determine man's standing in society, his character, his ability, his worth, his prospects, and his power of accomplishment, this can only be done by a knowledge of the conditions that surround him, with which he deals, and by which he is largely governed. A man's ability to interpret the true nature of these conditions will be assisted immeasurably by his familiarity with those precepts of human action and those principles of agricultural, industrial, and commercial development which have controlled the destinies of mankind and promoted the progress of civilization.

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